MISSISSIPPI LAW JOURNAL

ARTICLE

THE EFFECT OF BANKRUPTCY AND ENCUMBRANCES ON MINERAL INTERESTS IN MISSISSIPPI

William C. Noblin, Jr.

COMMENTS

A CONSTITUTIONAL ANALYSIS OF THE MISSISSIPPI COMMERCIAL CODE'S CONFLICT OF LAWS PROVISION

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I. Introduction

The severe problems that have plagued our economy in recent years have created considerable activity in the area of liens and encumbrances.[1] Substantial changes in this area of law have been wrought by various legislative enactments—for example, Mississippi's revision of several attachment statutes to eliminate recognized due process shortfalls,[2] and Congress' enactment of the Bankruptcy Reform Act of 1978 [the Reform Act].[3] These changes, along with the intricacies of existing law, have rendered the issuance of title opinions in the area of mineral leasing increasingly treacherous for even the experienced attorney.

This article is intended to serve as a primer for the unsuspecting novice and as a reference tool for the more experienced title examiner. The article examines the statutory or common law basis of the various liens and encumbrances that affect title to real property and of which the title examiner should be aware. The various peculiarities and intricacies of each type of encumbrance, as they relate to oil, gas, and mineral interests, are also discussed. Finally, some methods of curing the encumbered title are set forth.

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[1] The number of personal federal bankruptcy filings has increased from about 203,000 in 1978 to almost 528,000 in 1982. Commercial Law League Ass'n, Bankruptcy Reform Act Manual 2 (2d ed. 1982). In addition to the increase in bankruptcies, the number of liens and other encumbrances on real property have been growing in number, as have the foreclosures of such encumbrances. *See* Report of the Committee on Mortgage Law and Practice, *Cost and Time Factors in Foreclosure of Mortgages*, Real Prop. Prob. & Tr. J. 413, 414 (1968).

[2] *See, e.g.*, Miss. Code Ann. § 11-31-2 (Supp. 1983) (adding the requirement of a prompt post-seizure hearing to the remedy of attachment in chancery); *see also infra* note 263 and accompanying text.

[3] The Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978) (effective October 1, 1979).

II. Federal Bankruptcy Liens and Encumbrances

Prior to the enactment of the Bankruptcy Reform Act on October 1, 1979, the Bankruptcy Act of 1898[4] controlled the administration of the estates of individuals and organizations in bankruptcy. The Reform Act substantially changed the procedures for administering the bankruptcy estate and greatly modified the rights and obligations both between the debtor and his creditors and among the creditors. The scope of this section is limited strictly to the effect of the Reform Act on oil, gas, and mineral titles in Mississippi, and no endeavor has been made to discuss the effect of the prior law on mineral titles in this state. Because the effect of the United States Supreme Court's decision in *Northern Pipeline Construction Co. v. Marathon Pipeline Co.*[5] on the Reform Act's broad grant of jurisdiction to the bankruptcy courts to decide pendent claims[6] remains uncertain,[7]

---

[4] Ch. 541, 30 Stat. 544 (repealed 1979).

[5] 458 U.S. 50 (1982).

[6] In *Northern Pipeline Constr. Co.*, the insolvent Northern Pipeline had filed a reorganization petition under Chapter 11 of the Reform Act with the United States Bankruptcy Court. *Id.* at 56. Among the assets of the bankruptcy estate was a claim for damages against Marathon Pipeline Co. for breach of contract, breach of warranty, misrepresentation, coercion, and duress. *Id.* This claim was the subject matter of a lawsuit already pending in a federal district court. Marathon Pipeline Co. v. Northern Pipeline Constr. Co., 12 Bankr. 946, 947 (D. Minn. 1981), *aff'd sub nom.* Northern Pipeline Constr. Co. v. Marathon Pipeline Co., 458 U.S. 50 (1982). When Northern Pipeline sought to have the bankruptcy court adjudicate the damages claim incident to its consideration of the proffered plan of reorganization, Marathon objected on the ground that only Article III judges could adjudicate controversies concerning property not in the actual or constructive possession of the court. 458 U.S. at 52-53. Marathon maintained that because bankruptcy judges were not given life tenure, were subject to salary diminution, and could be removed by means other than impeachment, they could not be vested with plenary jurisdiction. 458 U.S. at 53; *In re* Northern Pipeline Constr. Co., 6 Bankr. 928, 929-30 (Bankr. D. Minn. 1980). Marathon argued that Article I, Section 8 of the United States Constitution, which gave Congress the power "[t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States," did not impose such restrictions on the tenure of bankruptcy judges, but did implicitly limit the jurisdiction of the bankruptcy courts to "controversies involving property in the actual or constructive possession of the court." 458 U.S. at 53. The bankruptcy court denied Marathon's motion to dismiss for lack of subject matter jurisdiction. 6 Bankr. at 932. On appeal, the district court found Marathon's argument compelling; it reversed and dismissed the damages complaint. 12 Bankr. at 947. Northern Pipeline and the United States, as intervenor, appealed to the United States Supreme Court, which affirmed. 458 U.S. at 88. The Court, however, stayed the effect of its judgment until October 4, 1982 to "afford Congress an opportunity to reconstitute the bankruptcy courts or to adopt other valid means

it, too, has been excluded from this discussion.

A. *Property in the Bankruptcy Estate*

Under the Reform Act, the filing of a petition with the court commences the bankruptcy case and creates the debtor's bankruptcy estate.[8] The estate consists of "*all* legal or equitable interest of the debtor in property," wherever located, subject to limited exceptions.[9] This language is extremely broad and covers any rights and interests of the debtor in real property, whether legal or equitable, including contingent interests.[10] The Act requires inclusion of all such property whether acquired by the debtor before the commencement of the bankruptcy proceedings or within 180 days after the filing of the petition. Thus, if within the 180 day period a debtor acquires or becomes entitled to acquire property by bequest, devise or inheritance, as a result of a property settlement agreement with the debtor's spouse, or as a result of an interlocutory or a final divorce decree, that interest in property will also become property of the estate.[11] This 180-day provision would sweep into the estate any accretions of property to the estate—such as proceeds, products, offspring, rents, royalties, or profits.[12] Once identified as included, prop-

---

of adjudication, without impairing the interim administration of the bankruptcy laws." *Id.*

[7] For a brief discussion of the present status of the *Marathon* controversy, see *Congress Scan: Picking up the Pieces of the Bankruptcy Courts*, 69 A.B.A. J. 1378 (1983).

[8] *See* 11 U.S.C. §§ 301, 302(a), 303(a), 541(a) (1982) (cases commence with filing of petition with the bankruptcy court). *See also* S. Rep. No. 989, 95th Cong., 1st Sess. 321 (1977) (background discussion).

[9] 11 U.S.C. § 541(a)(1) (1982). Under the Reform Act even exempt property is included in the estate, where it remains unless the debtor claims his exemption and demonstrates that the property is subject to exemption. *Compare* 11 U.S.C. § 522(l) (1982) *with* 11 U.S.C. § 522(b) (1982). *See generally* Ayers, *Commencing A Case Under the Bankruptcy Reform Act of 1978: A Primer*, 51 Miss. L.J. 639, 675 (1981) (background discussion for the proposition).

The Reform Act legislatively abrogated the rule of Lockwood v. Exchange Bank, 190 U.S. 294 (1903), which had interpreted the exemption provisions of the Bankruptcy Act of 1898 to prevent title of exempt property from ever passing to the trustee in bankruptcy.

[10] *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 367-69 (1977); *see generally* 4 Collier on Bankruptcy ¶ 541.07[1] (15th ed. 1981) (background discussion).

[11] 11 U.S.C. § 541(a)(5) (1982).

[12] 11 U.S.C. § 541(a)(6) (1982).

erty may be removed from the bankruptcy estate only upon assertion of a statutory exemption supported by proof from the debtor that the property is indeed exempt; the exemption is waived if not asserted.[13]

B. Filing the Bankruptcy Petition

A debtor filing bankruptcy must file his petition with the United States Bankruptcy Court in the federal court district in which the debtor has had his principal place of business, his residence, or his domicile for the preceding six months or the longest portion of the preceding six months.[14] If the debtor is a corporation or a partnership, its petition may be filed in the federal court district where the entity has had its principal assets for the preceding six months.[15]

The bankruptcy petition, though it is required to be filed in only one district, nevertheless will cover all property of the debtor wherever it might be located.[16] Since there is no requirement that a copy of the petition or bankruptcy proceedings be filed with any local court of record (either state or federal), a

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[13] 11 U.S.C. § 522(d) (1982) sets out exemptions that the debtor may claim. Included among these is an exemption for the debtor's interest, up to $7,500 in value, in real property that the debtor or his dependents use as a residence. *Id.* The debtor may, in the alternative, elect to take the exemptions available under state law. *Id.* § 522(b).

In Mississippi, a debtor electing state law exemptions may claim up to 160 acres of land on which his residence is located as a homestead exemption. The total value of the house and land for which exemption is sought, however, may not in any event exceed $30,000. MISS. CODE ANN. § 85-3-21 (Supp. 1983). *See also supra* note 9.

[14] 11 U.S.C. Rule 116(a)(1) (1982).

[15] 11 U.S.C. Rule 116(a)(2) (1982). 28 U.S.C. § 1472 (Supp. V 1981), which will supersede Rule 116 effective April 1, 1984, provides:

> Except [in cases ancillary to foreign proceedings], a case under title 11 may be commenced in the bankruptcy court for a district—
>
> (1) in which the domicile, residence, principal place of business, in the United States, or principal assets, in the United States, of the person or entity that is the subject of such case have been located for the 180 days immediately preceding such commencement, or for a longer portion of such 180-day period than the domicile, residence, principal place of business, in the United States, or principal assets, in the United States, of such person were located in any other district; or
>
> (2) in which there is pending a case under title 11 concerning such person's affiliate, general partner, or partnership.

[16] 11 U.S.C. § 541(a) (1982) (petition covers all property of the debtor "*wherever located*") (emphasis added).

title examiner is faced with the problem of determining whether or not a person or corporation in a chain of title has been subjected to the bankruptcy laws. Section 549(c) of the Act, however, does provide that a trustee may not avoid a transfer of *real* property to a good faith purchaser who was without actual knowledge of the commencement of the case and who gave present fair equivalent value in exchange for the property. Similarly protected is a purchaser at a judicial sale, when the real property is located in a county other than the county in which the case is commenced, unless a copy of the petition was filed in the office where conveyances of real property in that county are recorded.[17] Under Mississippi law, a copy of the petition would have to be filed in the office of the chancery clerk of the county in which the land is situated.[18]

To illustrate, suppose a debtor who is a resident of Texas owns minerals in Mississippi. To obtain relief in bankruptcy, that debtor would file his petition with the United States Bankruptcy Court in the district in Texas in which he has resided for the preceding six months. The minerals he owns in Mississippi would then automatically become property of the estate and be subject to all of the rights and powers vested in the bankruptcy trustee. Unless a copy of the petition in bankruptcy, however, has been filed in the office of the chancery clerk in the county in Mississippi where the land is located, a bona fide purchaser giving present fair equivalent value for those minerals and having no actual notice of the bankruptcy proceedings should acquire good title to the mineral interest.

C. Trustee in Bankruptcy—Rights and Powers

Under the Reform Act, the rights and powers of a trustee in bankruptcy, or a debtor-in-possession under Chapter 11 reorganization proceedings,[19] are extensive and remarkable. The trustee

---

[17] 11 U.S.C. § 549(c) (1982).

[18] MISS. CODE ANN. § 89-5-1 (1972).

[19] 11 U.S.C. § 1107 (1982) grants the Chapter 11 debtor, who remains in possession of the property of the estate, powers similar to those of a trustee in a Chapter 7 case. *See generally* Ayers, *supra* note 9, at 692-93 (background discussion regarding the debtor-in-possession).

has the right to the use, sale or lease of property of the estate.[20] He may elect either to assume or reject certain executory contracts and unexpired leases,[21] and has the power to avoid certain conveyances and transactions, referred to as preferences, to bring the property back into the estate.[22]

Section 363(b) of the Reform Act defines the trustee's powers to use, sell or lease property of the estate. If the use, sale or lease of property of the estate is in the ordinary course of business, the trustee may enter into the transaction without giving notice or holding a hearing.[23] When the business in question is not authorized to be operated under the bankruptcy laws, or when it is authorized but the proposed action is not in the ordinary course of the business, the trustee must give notice before he can exercise the power.[24] The purpose behind the requirement of giving notice is to provide an opportunity for interested parties to object. If an objection to the use, sale or lease is made, a hearing must be conducted on the matter. With regard to sales, the Reform Act provides that the trustee may sell any item of property in the estate, free and clear of any interest of an entity other than the estate, if any one of the following is met: applicable non-bankruptcy law permits the disposition; the other entity consents; the interest is a lien and all entities having a legally protectable interest in the particular *res* consent to the sale; the proceeds of the sale exceed the amount of the lien; the interest to be disposed of is bona fide disputed by the trustee; or the entity with the protectable interest could be compelled to accept a money satisfaction of the interest in a legal or equitable proceeding.[25]

A provision of the Reform Act that is of particular interest to mineral owners allows the trustee to sell both the interest of

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[20] 11 U.S.C. § 363(b) (1982).

[21] 11 U.S.C. § 365 (1982).

[22] *See infra* notes 51 and 52, and accompanying text (discussion of preferences and fraudulent conveyances).

[23] 11 U.S.C. § 363(c)(1) (1982). There are certain limitations to this power. The business of the debtor must be authorized to be operated under sections 721, 1108 or 1304 of the Reform Act, and exercise of the power must not violate any order under one of these three sections. *See id.*

[24] 11 U.S.C. § 363(c)(2) (1982).

[25] *Id.* § 363(f) (1982).

the debtor and the interest of any co-tenant in the property that, immediately before the commencement of the case, was held by the debtor and the co-tenant as tenants in common, joint tenants or tenants by the entirety. Section 363(h) of the Reform Act authorizes such a sale if all of the following are met: partition in kind is impractical; sale of the estate's undivided interest would realize significantly less than a sale free of the interests of the co-owner; the benefit to the estate from the sale outweighs the detriment to the co-owners; and the property is not used in the production, transmission, or distribution for sale of electric energy or of natural or synthetic gas for heat, light or power.[26] The debtor's co-owner is protected by a right to purchase the property at the same price at which the sale is to be consummated — essentially a right of first refusal.[27] After the sale, the trustee must distribute to the co-owners of the property the proceeds attributable to their interest less the costs and expenses of the sale.[28]

One of the more controversial sections of the Reform Act, section 365, gives the trustee the power either to assume or to reject any executory contract or unexpired lease of the debtor, subject to the approval of the bankruptcy court. Although no precise definition of "executory contract" is provided in the Reform Act, the report of the House Judiciary Committee says that the term refers to "contracts on which performance remains due to some extent on both sides."[29] The report specifically excludes promissory notes on the basis that the only performance remaining after the creditor has advanced the funds is repayment.[30] One court has interpreted the term so expansively that only promissory notes are effectively excluded from its coverage.[31]

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[26] 11 U.S.C. § 363(h) (1982).

[27] *Id.* § 363(i) (1982).

[28] *Id.* § 363(j) (1982).

[29] *Compare* 11 U.S.C. § 101 (1982) (definitions) *and id.* § 365 (1982) (trustee's power to reject executory contracts and unexpired leases) *with* H. Rep. No. 595, 95th Cong., 1st Sess. 347 (1977) *and* S. Rep. No. 989, 95th Cong., 2d Sess. 58 (1978) (discussing the proposition).

[30] H.R. Rep. No. 595, 95th Cong., 1st Sess. 344-46 (1977).

[31] *See In re* Rovine Corp., 6 Bankr. 661 (Bankr. D. Tenn. 1980) (franchisor's duties of co-operation and best efforts to maintain the reputation of the franchise sufficient to render agreement "executory"), *citing with approval*, V. Countryman, *Executory Con-*

If the bankruptcy is filed under Chapter 7 of the Reform Act (straight liquidation), the trustee has sixty days after the filing of the petition within which to either assume or reject an executory contract or an unexpired lease of the debtor. If the trustee has taken no action within this sixty day period, however, the contract or lease is deemed automatically rejected.[32]

If the bankruptcy is proceeding under Chapter 9 (adjustment of debts of a municipality), Chapter 11 (reorganization) or Chapter 13 (adjustment of debts of individual with regular income), the trustee may elect either to assume or to reject an executory contract or unexpired lease of the debtor at any time before the confirmation of a debt repayment plan. A party to such a contract or lease, however, may petition the bankruptcy court to order the trustee to determine within a specified period of time whether to assume or reject the contract or lease.[33]

The Reform Act does not contain any express standards to determine when an executory contract or an expired lease may be rejected, so the attorney must look to the courts and the developing case law for guidance. Some courts require a showing that the executory contract is onerous and burdensome, and that the equities decidedly tip in favor of its termination.[34] Other courts use the "business judgment" test.[35]

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tracts in Bankruptcy: Part II, 58 MINN. L. REV. 479, 501-02 (1974) (patentee-licensor's warranty of the validity of their patents "is enough to justify the treatment of all unexpired patent licenses as executory contracts"). Virtually every contract carries either a warranty, a mutual duty of co-operation, or a mutual duty of best efforts. *See, e.g.*, MISS. CODE ANN. § 75-2-314 (1972) (a warranty of merchantability is implied in a contract for the sale of commercial goods); *id.* § 11-7-18 (Supp. 1983) (the implied warranty of merchantability cannot be limited or disclaimed).

[32] 11 U.S.C. § 365(d)(1) (1982).

[33] 11 U.S.C. § 365(d)(2) (1982).

[34] 6 ALI-ABA COURSE MATERIALS J. No. 5, at 16 (1982).

[35] *See, e.g.*, Control Data Corp. v. Zelman (*In re* Minges), 602 F.2d 38 (2d Cir. 1979). The "business judgment" test was originally applied in railroad reorganization cases to determine if unexpired leases could be rejected by the trustee. *See* Silverstein, *Rejection of Executory Contracts*, 31 U. CHI. L. REV. 467, 468-72, 480 n.58, 500 n.135 (1964). In Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pac. R.R., 318 U.S. 523 (1943), the United States Supreme Court refused to limit the trustee's power to reject executory contracts and unexpired leases to only unprofitable contracts. The Court held that even a profitable contract or lease could be rejected by the trustee since "the question whether a lease should be rejected and if not on what terms it should be assumed is one of *business judgment.*" *Id.* at 550 (emphasis added).

For example, in the case of *In re Tilco, Inc.*,[36] the bankruptcy trustee sought to reject debtor's contracts to sell natural gas to Mobil Oil Corporation. The trustee sought to reject the contracts as "executory contracts" under the predecessor of the Reform Act's section 365, so that the estate could sell its natural gas at the current high market price rather than the low contract price.[37] The United States District Court for the District of Kansas held that gas purchase contracts were executory, because no payments were made or yet due for undelivered gas and the contracts typically contained language to the effect that title to the gas did not pass until delivery. The court said that rejection of executory contracts, however, would be allowed only when such contracts were shown to be burdensome or disadvantageous to the debtor's estate and to the interest of its creditors. The court found the contracts under scrutiny to be profitable, even if not as profitable as prevailing market rates would be, and therefore, not burdensome to the estate.[38] On appeal, the Tenth Circuit Court of Appeals reversed the district court, stating that under the "business judgment test," the production of substantial net revenue was not determinative.[39] The Tenth Circuit remanded for a hearing on the benefits and detriments to the es-

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Without expressly using the "business judgment" terminology, a number of courts have employed the test in affirming rejections of profitable contracts and leases when renegotiation at prevailing market rates would benefit the estate. *See, e.g.*, Rivercity v. Herpel (*In re* Jackson Brewing Co.), 567 F.2d 618, 623-24 (5th Cir. 1978) (trustee allowed to reject long-term land-purchase option contract when present market value far exceeded the purchase price provided).

In *Control Data Corp. v. Zelman*, the Second Circuit adopted the test, stating:

> We believe that such a flexible test for determining when an executory contract may be rejected, however termed (and "business judgment" is as good a label as any), is most appropriate. . . . A rigid test, permitting rejection only where the executory contract will cause a net loss to the debtor's estate if performed, might work a substantial injustice in cases where it can be shown that the non-debtor contracting party will reap substantial benefits under the contract while the debtor's creditors are forced to make substantial compromises of their claims.

602 F.2d at 43.

[36] 408 F. Supp. 389 (D. Kan. 1976), *rev'd sub nom.* Carey v. Mobil Oil Corp. (*In re* Tilco Inc.), 558 F.2d 1369 (10th Cir. 1977).

[37] 558 F.2d at 1370.

[38] 408 F. Supp. at 402-03.

[39] 558 F.2d at 1372.

tate that might accrue from a rejection.[40] If the Tenth Circuit's interpretation of the business judgment test flourishes, it may be possible for a trustee to reject a profitable executory contract if he can show that it can be replaced with a contract more profitable to the bankruptcy estate.

Section 365 of the Reform Act expressly provides for identical treatment of "executory contracts" and "unexpired leases" in the assumption and rejection context. Since the Reform Act does not define the term "unexpired lease,"[41] the question arises whether it may be used to reject an otherwise valid oil, gas, and mineral lease [hereafter "mineral lease"]. Assume that a mineral lease has been executed, and subsequent to the time that the lease is executed, the lessor files for bankruptcy. In Mississippi, a mineral lease does not constitute a lease of real property per se but rather an estate in land known as a determinable fee, which in simple terms means the "lessee's" estate in minerals reverts to the lessor upon the happening of certain events stated in the lease, usually the failure to pay annual delay rentals or failure to obtain and continue production in paying quantities.[42] Consequently, if the bankruptcy court and the trustee look to state law to determine the type of estate or interest a mineral lease creates, in a proceeding concerning a lease in Mississippi the trustee should not be allowed to use his section 365 powers to avoid a mineral lease.

No cases have been found applying Mississippi law in such situations. In *Hill v. Larcon, Co.*,[43] however, the United States District Court for the Western District of Arkansas apparently equated a mineral lease with a lease of real property within the meaning of the predecessor to section 365 of the Reform Act.[44]

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[40] 558 F.2d at 1372-73.

[41] *See supra* notes 29 and 30.

[42] Koenig v. Calcote, 199 Miss. 435, 450-53, 25 So. 2d 763, 765-66 (1946).

[43] 131 F. Supp. 469 (W.D. Ark. 1955).

[44] Although it held that the oil and gas lease had been lost by abandonment, the court said:

> [Lessor] contends that the Trustee in Bankruptcy did not accept or assume the lease . . . within sixty days after the adjudication of bankruptcy, as required by 11 U.S.C.A. § 110, sub. b, and that the Trustee therefore acquired no title to said lease and . . . could not transfer the same . . . .
>
> [Lessor] is correct in his contention that the failure of a trustee to take

Therefore, should a trustee in a Chapter 7 (liquidation) proceeding fail to take affirmative action to assume a mineral lease within sixty days of the filing of the petition, the lease would be deemed automatically rejected.[45] If the bankruptcy courts follow *Hill v. Larcon Co.*,[46] and treat a mineral lease as "an unexpired lease of real property" without regard to state law,[47] section 365 of the Reform Act would become highly significant to mineral lessors and lessees.

In a situation in which the bankruptcy debtor is the lessor under an unexpired lease of real property and the lease is rejected by the trustee as a "lease of real property," the Reform Act provides the lessee with two options: the lessee may elect to treat the lease as terminated and relinquish possession of the property, or the lessee may elect to remain in possession for the duration of the lease, including any extension of the lease term as provided for in the lease itself.[48] In other words, rejection of the lease merely cancels any obligations under the lease which the debtor-lessor is obligated to perform in the future, but does not terminate the lessee's right to possession under the lease. In view of the fact that the lessor of a mineral lease has very few obligations, if any, to perform in the future, the lessor's bankruptcy followed by rejection of a mineral lease by the trustee, should have no impact upon the rights of the lessee. Therefore, even if a mineral lease is rejected under section 365, the lessee would still be entitled to remain in possession and retain its leasehold interest for as long as the lease term provides. It is very doubtful, therefore, that a mineral lease, in which the lessor

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> affirmative action within 60 days to adopt or reject a lease amounts to a rejection of the lease. [Citations to non-mineral lease cases omitted]. In the instant case there was no direct evidence as to whether the first Trustee . . . accepted or rejected the lease within 60 days after the adjudication of bankruptcy . . . . However, it was clear from the evidence that . . . the second Trustee . . . intended to and did abandon and reject the lease.

131 F. Supp. at 474. The original trustee had resigned so a substitute trustee was named. *Id.* at 472.

[45] *See supra* notes 32-33 and accompanying text.

[46] 131 F. Supp. 469 (W.D. Ark. 1955).

[47] *Cf. In re* Newkirk Mining Co., 238 F. Supp. 1, 2-4 (E.D. Pa. 1964) (coal lessee's trustee allowed to reject lease without terminating lessee's rights to sell coal mined on leased premises), *aff'd mem.* 351 F.2d 954 (3d Cir. 1965).

[48] 11 U.S.C. 365(h)(1) (1982).

is the debtor in bankruptcy, will be rejected primarily because the lessor's interest in the rents and royalties accruing under the lease will be administered as definite assets of the estate.[49]

Even if the bankruptcy courts look to applicable state law regarding mineral leases and determine that section 365 does not apply, they may still allow the trustee to avoid the lease by recharacterizing it as either a preferential transfer or a fraudulent conveyance. Section 547(b) provides that payments or transfers of property to unsecured creditors in satisfaction of antecedent indebtedness within ninety days of the filing of the petition are "preferences," and as such, they are vulnerable to attack by the trustee.[50] Section 548 gives the trustee the power to avoid any transfer by the debtor of an interest in property that was made within one year of the date of the filing of the petition, if the transfer was made for the purpose of defrauding creditors or for less than adequate consideration at a time when the debtor was insolvent.[51] Generally, however, the trustee will not be able to avoid a validly executed mineral lease under either section because the lessee will presumably have paid valuable consideration without the intent to defraud or hinder creditors, and the lessee will not have taken it on account of an antecedent debt owed by the lessor.

D. Application

Assume a situation in which one wants to take a lease from a mineral owner. Records of the bankruptcy court in the district in which the mineral owner must file for bankruptcy have been checked, and it has been determined that the mineral owner has filed for bankruptcy. What steps are necessary to obtain a valid lease?

Once the mineral owner has filed for bankruptcy, all of his property has entered his bankruptcy estate. From that point in time all negotiations must be conducted with the trustee. In

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[49] *See* 2 COLLIER ON BANKRUPTCY ¶ 365.09 (15th ed. 1983); *In re* New York Investors Mutual Group, Inc., 153 F. Supp. 772, 775, (S.D.N.Y. 1957), *aff'd sub. nom.* Cohen v. East Netherland Holding Co., 258 F.2d 14 (2d Cir. 1958).

[50] 11 U.S.C. § 547(b) (1982).

[51] 11 U.S.C. § 548(a) (1982).

most instances the leasing of a mineral interest will not be in the ordinary course of business of the mineral owner, and one will have to proceed under section 363(b), which requires the trustee to give notice, and if necessary, a hearing. If the mineral interest of which a lease is desired, however, comprises all or part of the debtor's homestead and the debtor has properly claimed his homestead exemption, then the owner may be dealt with directly.

Suppose that there is a validly executed mineral lease in effect and the lessor files a petition in bankruptcy; what effect will that filing have on the lease? If the bankruptcy court characterizes a mineral lease according to state law as "an unexpired lease of real property," the lease *may* be rejectable by the estate even though it is currently profitable or the value of the lease has changed significantly since it was executed.[52] As a result, the solvent party may be forced into renegotiating the lease with the trustee at a considerably higher cost. If the bankruptcy court characterizes a mineral lease as "an unexpired lease of real property," rejection by the lessor's estate should merely extinguish the duties, if any, owed by the lessor under the lease, leaving the lessee free to develop the minerals.

If the lessee files a bankruptcy petition after execution of a mineral lease for fair and adequate consideration, the lessee's bankruptcy trustee may wish to assume, so that he may assign or convey an interest in the lease or enter into a farmout agreement[53] or other contract in relation to the lease. Depending upon whether such activities would be considered to be in the ordinary course of the lessee's business, the trustee may be unable to consummate a deal until there has been notice and a hearing involving all interested parties. If no assignment is made by an assuming trustee of a debtor-lessee's interest in a mineral lease, the trustee will be required to observe the lease terms and make timely payments of delay rentals or the lease will be lost by termination.[54]

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[52] *See In re* J.H. Land & Cattle Co., 8 Bankr. 237, 239 (W.D. Okla. 1981), in which the bankruptcy court allowed the debtor-lessor under the "business judgment" test to oust the lessee.

[53] *See infra* note 92.

[54] *See* Good Hope Refineries, Inc. v. Benavides, 602 F.2d 998, 1000 (1st Cir. 1978),

III. Liens and Encumbrances Arising Under State Insolvency Laws

A. Receiverships

As a possible alternative to federal bankruptcy, Mississippi provides for the appointment pursuant to an order of the chancery court of a receiver who is given possession of the property of the debtor for the common benefit of creditors.[55] The purpose of a receivership is to preserve the status quo of the existing rights of the parties involved when it could not be maintained by leaving the property in the hands of the debtor.[56] The state court remedy of receivership differs from federal bankruptcy law in that the state proceedings do not attempt to adjudicate the rights of the parties to the property — the purpose is merely to preserve the property until the rights are finally adjudicated or settled in a separate proceeding.[57]

The grounds for the appointment of a receiver in Mississippi are set forth in *Clark v. Fleming*.[58] In that case, the Mississippi Supreme Court held that to be entitled to the appointment of a receiver the plaintiff must show three things: that he has a protectable interest in the property that is sought to be placed in the legal custody of the court; either defendant's possession was fraudulently obtained or there is danger of loss or harm to the property by defendant's wrongful action or inaction; and there is no other adequate remedy under the circumstances.[59]

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cert. denied, 444 U.S. 992 (1979).

[55] The Mississippi statutes governing receiverships are found at Miss. Code Ann. §§ 11-5-151 to -167 (1972). Although the adoption of new rules of civil procedure made substantial changes in state court practice, Rule 66 indicates that procedural conventions concerning receiverships were left unaffected. *See* Miss. R. Civ. P. 66 (Miss. St. Bar ed. 1981).

[56] *See* Clark v. Fleming, 130 Miss. 504, 510, 94 So. 458, 460 (1923) (quoting 4 Pomeroy's Equity Jurisprudence § 1484 (4th ed. 1919)).

[57] *See* V. Griffith, Mississippi Chancery Practice § 466, at 468 (2d ed. 1950).

[58] 130 Miss. 504, 94 So. 458 (1923).

[59] In *Clark v. Fleming*, the court stated: The appointment of a receiver is, as a general rule, discretionary . . ., and based upon the fact that there is no other adequate remedy . . . . 130 Miss. at 510, 94 So. at 460 (quoting 4 Pomeroy's Equity Jurisprudence § 1484 (4th ed. 1919)). The court also said:

> [T]he plaintiff must show, first, either that he has a clear right to the

The plaintiff must seek appointment of a receiver as an auxiliary remedy to an independent claim in equity or at law.[60]

The procedural requirements for appointment of a receiver include publication of notice to all interested parties declaring that the petition for appointment has been filed with the court and will be acted upon after a hearing to be held on the date specified in the notice.[61] Once the receiver has been appointed, all creditors and other interested parties are notified, through a general order of publication of the receivership, to appear within a reasonable time and state their claims. As the creditors appear, they then become parties to the cause and are entitled to establish their claim and to contest the claims of others.[62]

Upon appointment, a receiver immediately takes possession and control[63] of the debtor's[64] property, but that possession is not adverse or hostile to the rights of the debtor or to any inter-

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> property itself; or that he has some lien upon it; or that the property constitutes a special fund to which he has a right to resort, for the satisfaction of his claim. And secondly, that the possession of the property by the defendant was obtained by fraud; or that the property itself, or the income arising from it, is in danger of loss from the neglect, waste, misconduct or insolvency of the defendant.

130 Miss. at 511, 94 So. at 460 (quoting from Mays v. Rose, 1 Freem. Ch. 703, 718 (Miss. Super. Ct. Ch. 1844)).

[60] *See* Engelburg v. Tonkel, 140 Miss. 513, 522, 106 So. 447, 448 (1925) (appointment "must be ancillary or not at all").

[61] *See* Buckley v. Baldwin, 69 Miss. 804, 807, 13 So. 851, 852 (1892) (only urgent circumstances allow appointment without prior notice and hearing); MISS. CODE ANN. § 11-5-153 (1972) (requiring five days' notice).

[62] V. GRIFFITH, *supra* note 57, § 478.

[63] As stated by V.A. Griffith in his noted treatise on chancery practice:

> [T]he property is from the date of the appointment considered to be *in custodia legis* to the extent that thereafter no person is permitted by any proceedings subsequent to the appointment to affix any lien or preference on the property so taken. V. GRIFFITH, *supra* note 57, § 477.

[64] In addition to the appointment of receivers for insolvent individuals, the Mississippi Code also provides for the appointment of a receiver in the event a corporation is liquidated. MISS. CODE ANN. § 79-3-195 (1972). The chancery court is given the power to appoint a temporary receiver with such powers and duties as the court may direct in order to preserve the corporate assets and to carry on the business of a corporation in liquidation until a full hearing can be had. After a full and complete hearing, the court may appoint a liquidating receiver with the authority to collect the assets of the corporation, and to sell, convey, and otherwise dispose of them through either public or private sale. The proceeds from liquidation sales are then applied by the receiver to the expenses of the liquidation and to the payment of liabilities and obligations of the corporation. *Id.*

ested party because the receiver holds possession for the "greater safety of all the parties concerned."[65] The receiver has the authority to sell or lease the debtor's property if necessary to preserve all rights to the property existing at the time of his appointment.[66] Since the receiver can acquire no greater interest in the property than the debtor had,[67] any liens or priorities acquired prior to the appointment cannot be disturbed. All subsequent purchasers and encumbrancers, however, are subject to the rights and powers of the receiver.[68]

B. Assignments for the Benefit of Creditors

Another alternative to federal bankruptcy is a general assignment for the benefit of creditors. This remedial measure allows the debtor to assign all his non-exempt property to an assignee who then takes it and sells it for the benefit of creditors.[69] Traditionally available at common law, the remedy of general assignment for the benefit of creditors is now governed by statute in Mississippi.[70] If the value of the property assigned exceeds one thousand dollars, these statutes require the assignee to file a petition in the chancery court in the county of the debtor-assignor's residence or place of business within twenty-four hours after taking possession of the debtor's property.[71] Upon the filing of a petition in the chancery court and the approval of the bond of the assignee, the assignee becomes a receiver of the court with the same rights, duties and obligations as other receivers in equity.[72]

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[65] V. GRIFFITH, *supra* note 57, § 467 (2d ed. 1950).

[66] *See id.* § 480.

[67] V. GRIFFITH, *supra* note 57, § 477, at 480.

[68] P.E. Payne Hardware Co. v. International Harvester Co., 110 Miss. 783, 786, 70 So. 892, 893 (1916).

[69] *See* Union Planters' Bank v. Allen, 77 Miss. 442, 452, 27 So. 631, 633 (1900).

[70] *See* MISS. CODE ANN. §§ 85-1-1 to -19 (1972) (statutes governing general assignments). *See also* Lowenstein v. Hooker, 71 Miss. 102, 105, 14 So. 531, 531 (1893) (only general assignments may be brought into chancery court under these statutes).

[71] MISS. CODE ANN. § 85-1-1 (1972).

[72] *Id.* § 85-1-7 (1972).

C. Application

In the event an owner of real property is the subject of a receivership or an assignment for the benefit of creditors, all transactions with respect to the leasing or buying of his mineral interest should be conducted through the receiver,[73] and approved by the chancery court. Otherwise, the lease or conveyance could be voided by the receiver since he, not the debtor, had legal custody and control of the property in question. As with receiverships of property of individuals, any transactions sought to be conducted concerning the property of a corporation in liquidation that has a receiver appointed, should be conducted through the receiver.

IV. Mortgages, Deeds of Trust, Vendor's Liens and Other Consensual Liens

A. Mortgages and Deeds of Trust

Although the traditional mortgage[74] is valid in Mississippi, the deed of trust[75] is utilized almost exclusively in the state as the means of securing debts and obligations with real property.[76]

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[73] Once approved by the court, the assignee of a general assignment for the benefit of creditors becomes a receiver. Miss. Code Ann. § 85-1-7 (1972).

[74] A "traditional" mortgage is a two party instrument that conveys to a creditor, or mortgagee, a security interest in a specific res, typically a parcel of real property of the debtor, or mortgagor. *See* Black's Law Dictionary 911 (5th ed. 1979). If the mortgagee, acting under a power of sale, carries out the foreclosure sale he cannot purchase the property at the public sale. *See, e.g.,* Jackson v. Blankenship, 213 Ala. 607, 105 So. 684, 685 (1925). *See generally* G. Osborne, G. Nelson & D. Whitman, Real Estate Finance Law § 7.21, at 486 (1979).

[75] A deed of trust is a three-party instrument that creates a security interest in specified property. The debtor, or grantor, conveys legal title in the specific res in trust to a trustee to be sold by that trustee at public sale for the benefit of the creditor, or beneficiary, in the event the debtor defaults on the secured indebtedness. *See e.g.,* Baker v. Connecticut Gen. Life Ins. Co., 196 Miss. 701, 709, 18 So. 2d 438, 440 (1944). *See generally* Black's Law Dictionary 1356 (5th ed. 1979) (discussion of trust deeds generally). When the security interest is given by deed of trust, the mortgagee is free to purchase the security at the foreclosure sale. *See, e.g.,* Home Owners Loan Corp. v. Wiggins, 188 Miss. 750, 757-59, 195 So. 339, 340-41 (1938). *See generally* G. Osborne, G. Nelson & D. Whitman, *supra* note 92, § 7.21, at 486.

[76] *See* Committee on Mortgage Law and Practice, *Cost and Time Factors in Foreclosure of Mortgages,* Real Prop. Prob. & Tr. J. 413, 414 (1968).

Once the grantor has executed and delivered a deed of trust to the trustee for the benefit of the beneficiary, a lien upon the real property therein described arises in the amount of the indebtedness owed the beneficiary by the debtor-grantor.[77] Although the deed of trust is binding as between the debtor and the trustee,[78] the deed of trust must be recorded in the local land records in order to bind subsequent purchasers and affect encumbrancers.[79] Unless the property is foreclosed upon, the grantor continues to hold legal title to the property.[80] The lien and remedies for enforcement of a deed of trust are extinguished when the underlying debt is paid[81] or when it becomes time-barred.[82] When either

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[77] MISS. CODE ANN. § 89-1-43 (1972). If the land covered by the deed of trust is homestead property, the spouse of the owner must sign to validate the instrument. MISS. CODE ANN. § 89-1-29 (1972).

[78] *See* MISS. CODE ANN. § 89-5-3 (1972).

[79] *See* MISS. CODE ANN. § 89-5-5 (1972). To provide notice to third parties, the deed of trust or mortgage must be acknowledged or proved and filed for record in the office of the chancery clerk of the county in which the real property is situated, as any other conveyance of real property. *See id.* §§ 89-5-1, -3 (1972). Mortgages and deeds of trust are usually recorded in the sectional indices but index books maintained solely for mortgages and deeds of trust on real property are required to be kept by statute. *See id.* § 89-5-29 (1972).

The priority of the lien created by a deed of trust filed of record is set forth in MISS. CODE ANN. § 89-5-5 (1972), which provides that mortgages and deeds of trust:

> [s]hall take effect, as to all creditors and subsequent purchasers for a valuable consideration without notice, only from the time when delivered to the clerk to be recorded; and no [instrument] which is unrecorded or has not been filed for record, shall take precedence over any similar instrument affecting the same property which may be of record.

[80] *See, e.g.*, Baker v. Connecticut Gen. Life Ins. Co., 196 Miss. 701, 709, 18 So. 2d 438, 440 (1944). Although Mississippi affords the secured party a choice between judicial and non-judicial foreclosure, the latter is the most commonly resorted to. *See* Committee on Mortgage Law and Practice, *Cost and Time Factors in Foreclosure of Mortgages*, REAL PROP. PROB. & TR. J. 413, 414 (1978). MISS. CODE ANN. § 89-1-55 (1972) sets forth procedures for non-judicial foreclosure by a trustee under a power of sale, which must be contained in the instrument.

[81] MISS. CODE ANN. § 89-1-49 (1972).

[82] *See* MISS. CODE ANN. §§ 15-1-21, -49, 89-5-19 (1972). In Mississippi, the applicable statute of limitations is six (6) years from the date of maturity of the indebtedness, although the secured party is afforded an additional six (6) month period after this time in which to note a renewal of the lien on the record. *Id.* If the date of final maturity of the indebtedness cannot be ascertained from the face of the record, then the date of final maturity is one year from the date of the instrument. *Id.* § 89-5-19 (1972). Thus, failure to set forth in a deed of trust the actual date the indebtedness secured thereby matures or sufficient information from which this date can be ascertained will start the six (6)

occurs, the beneficiary is obliged to cancel the deed of trust of record and the debtor may bring suit to compel cancellation.[83]

(i) Application

The priority of a deed of trust is established upon the date and time of the instrument's filing,[84] so the lessee who obtains and duly files an oil, gas, and mineral lease prior to the filing of a pre-existing deed of trust covering the same lands will not take the leasehold subject to the deed of trust, unless the lessee has actual knowledge of the existence of that instrument or actual knowledge of sufficient facts to put him upon inquiry notice.[85] If the deed of trust has been previously filed for record or the lessee has actual knowledge of its existence when the oil, gas, and mineral lease is obtained, the rights of the lessee will be inferior to those of the trustee in the event of default resulting in foreclosure of the property. Should default occur, the lessee must take action to protect the leasehold from potential extinction. The lessee may obtain from the creditor-beneficiary either a subordination agreement under which the lien of the deed of trust is subordinated to the oil, gas, and mineral lease, or a partial release of the lien to the extent that it covers leased lands. If a subordination or partial release is unobtainable, the lessee may undertake to satisfy the indebtedness secured by the deed of trust and have the instrument cancelled of record. In any event, the lease form should provide that the lessee may discharge any mortgage or other lien upon the land, either in whole or in part, and thereby become subrogated to the lien with the right to en-

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year statute of limitations running one year from the execution date of the instrument. *See also infra* note 246 (discussing dormancy and revivor in this context).

[83] MISS. CODE ANN. § 89-5-21 (1972). Either the beneficiary or the trustee has the authority to acknowledge satisfaction of a deed of trust. Cancellation of the deed of trust may be accomplished by either the execution of an instrument authorizing the chancery clerk to cancel the deed of trust or a notation on the margin of the record of the deed of trust signed by the trustee or beneficiary and attested by the chancery clerk. *See also id.* § 89-5-23 (1972) (same for oil, gas, and mineral leases).

[84] *See supra* notes 78-79 and accompanying text.

[85] *See* Gulf Ref. Co. v. Travis, 201 Miss. 336, 370, 29 So. 2d 100, 103-04 (1947), *suggestion of error overruled*, 201 Miss. 39, 30 So. 2d 398 (1947) (mineral lessee will be charged with knowledge of facts reasonably discoverable when lessee has actual knowledge of essential facts sufficient to put him upon inquiry).

force it and to apply rentals and royalties accruing under the lease toward its satisfaction.

B. Vendor's Liens

A vendor's lien is an equitable lien in the nature of a purchase-money mortgage that attaches to property in favor of the seller to secure payment by the buyer of the purchase price.[86] The lien arises from the purchaser's nonpayment of part of the agreed purchase price and it runs only in favor of the seller who holds legal or equitable title to the transferred property.[87] A vendor's lien can be created by the express language in a deed of conveyance or it may be implied in law by the courts.[88] Whether the vendor's lien is express or implied, it is valid and binding between the parties, their heirs and all subsequent purchasers tendering inadequate consideration or having actual notice of the lien's existence. A vendor's lien is binding between the parties whether or not the instrument creating the lien has been properly filed and recorded.[89] The lien, however, is void as to all creditors and subsequent bona fide purchasers who have no actual knowledge of its existence.[90] The holder of the vendor's lien, therefore, must record the instrument in order to impart constructive notice of its existence and to establish its priority as to subsequent purchasers.

(i) Application

The vendor's lien is rarely utilized in modern practice, having been almost totally replaced by the deed of trust or mortgage. Nevertheless, the title examiner should be aware that it may exist, and be alert to language in a deed of conveyance in the lessor's chain of title that may be sufficient to put a title examiner upon inquiry if a lease is executed subsequent to the date the vendor's lien became effective, the vendor's lien should

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[86] *See* Wilkins v. Humphreys, 23 Miss. (1 Cush.) 311, 311-14 (1852).

[87] *See* J. M. Griffin Co. v. Jernigan, 170 Miss. 343, 351, 154 So. 342, 344 (1934).

[88] Scottish Union & Nat'l Ins. Co. v. Warren Gee Lumber Co., 118 Miss. 740, 758, 80 So. 9, 14-15 (1918).

[89] *Id.*, 80 So. at 14-15.

[90] See Wilkins v. Humphreys, 23 Miss. (1 Cush.) 311, 311-14 (1852).

be subordinated to the lease or partially released to protect the leasehold from potential extinction by foreclosure of the lien. When a vendor's lien is found to exist, a subordination or release should be obtained from the vendor.

C. *Contractual Liens*

Liens are often imposed on interests in real property by contracts such as operating agreements,[91] farmout and farmin agreements,[92] and the like. In operating agreements, the non-operators often grant the operator a lien upon their rights and interests in the oil and gas and equipment in order to secure the payment of each non-operator's share of expenses. The operator, in turn, often grants a lien to the non-operators for the same purpose. Constructive notice of the existence of contractual liens, as well as their priority, is accomplished by filing the agreement for record. It should be noted that if the particular contract filed for record does not actually set forth the lien but instead refers to an unrecorded agreement, the title examiner is put upon inquiry and charged with knowledge of any lien or encumbrance arising out of that agreement that could have been discovered by reasonable efforts.

V. Encumbrances Under the Uniform Commercial Code

A lien, or security interest, arises under Article 9 of the Uniform Commercial Code [UCC or the Code][93] when a party desiring to borrow money executes a security agreement to a lender. The UCC defines a "security agreement" as any consensual agreement entered into by a debtor that specifically pledges

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[91] An operating agreement essentially is an agreement between parties having a common interest in having a property developed—for example, concurrent owners—concerning testing and development of the property, accounting procedures, and the like. *See* H. Williams & C. Meyers, Manual of Oil & Gas Terms, 400 (5th ed. 1981).

[92] A farmout agreement is an agreement in which the owner of a lease assigns all or a part of the lease to another operator, in return for the operator's promise to drill one or more wells on the lease. *See id.* at 211.

[93] The Uniform Commercial Code was adopted by the Mississippi Legislature on May 31, 1966 and became effective March 31, 1968. 1966 Miss. Laws 315-18 (codified at Miss. Code Ann. §§ 75-10-101 to -105 (Repl. 1981)).

identified or identifiable personal property or fixtures as security for the performance of an obligation.[94] The UCC expressly excludes from its coverage the creation or transfer of interests in or liens on realty other than fixtures, including incidental leases or rents.[95] The Code refers to fixtures as personalty or goods[96] that have become so related to particular real estate that an interest in them arises under real estate law . . . .[97]

Article 9 applies not only to those transactions that have been traditionally viewed as creating a security interest but also to all transactions "intended to create a security interest in personal property or fixtures including goods, documents, instruments, general intangibles, chattel paper or accounts" including "any sale of accounts or chattel paper."[98]

Under Mississippi law, minerals in place constitute an interest in realty and do not become personalty until actually brought to the surface and reduced to possession.[99] Accordingly, Article 9 of the UCC should be inapplicable to a transaction in which a mineral owner uses his mineral estate to secure a loan. For the same reason, Article 9 should not be applicable to a royalty interest retained by a mineral owner upon the execution of a mineral lease, since a royalty payable under such a lease is an interest in the land itself.[100] Instead, the rights between and among subsequent lessees, assignees, purchasers, and encumbrancers should be determined in accordance with the local law

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[94] *See* MISS. CODE ANN. § 75-9-105(l) (1972) (defining security agreement as any that creates security interest); *id.* § 75-1-201(37) (1972) (defining security interest as any interest in personalty or fixtures that secures payment of debt or performance of an obligation); *id.* § 75-9-313(1)(a) (1972) (a fixture is personalty that becomes "so related to particular real estate that an interest in [it] arises under [state] real estate law").

[95] *Id.* § 75-9-104 (1972).

[96] *Id.* § 75-9-105(1)(h) (1972) defines "goods" to include: "all things which are movable at the time the security interest attaches or which are fixtures. . ., but does not include money, documents, instruments, accounts, chattel paper, general intangibles, or minerals or the like (including oil and gas) before extraction." *See also id.* § 75-9-105 (1972) (defining "document," "instrument," "chattel paper"); *id.* § 75-9-106 (1972) (defining "accounts" and "general intangibles").

[97] *Id.* § 75-9-313(1)(a) (1972).

[98] *Id.* § 75-9-102(1) (1972).

[99] Merrill Eng'g Co. v. Capital Nat'l Bank, 192 Miss. 378, 393, 5 So. 2d 666, 670 (1942).

[100] Dougherty v. Greene, 218 Miss. 250, 259, 67 So. 2d 297, 300 (1953).

of real estate mortgages.[101]

Although the UCC should be inapplicable to oil, gas, and mineral transactions prior to extraction or production, it may become collaterally involved in certain instances. To illustrate, assume a farmer borrows money from a lender to grow a crop of cotton and executes a security agreement pledging as collateral any cotton he might grow. After the lender properly files the security agreemeent of record, the farmer executes an oil, gas, and mineral lease covering the land on which the cotton is being grown. The lessee decides to drill a well in the middle of the cotton patch, and destroys a substantial portion of the cotton grown by the farmer. Since the security interest in cotton was perfected prior to the date the lease was executed, the security interest continues in the collateral notwithstanding a sale, exchange or other disposition of the collateral, and continues in identifiable proceeds given in exchange for the collateral, such as damages.[102] Thus, all negotiations concerning damages[103] to the cotton crop should include the lender as a party because he has a perfected security interest in the destroyed crop.

As a further illustration of the collateral involvement of the UCC in mineral transactions, consider its possible effect on the working interest in an oil, gas, and mineral lease. A working interest, like fee mineral and royalty interests,[104] may be considered realty rather than personalty in ownership-in-place jurisdictions. In *Ingram v. Ingram*,[105] the Kansas Supreme Court considered the question whether Article 9 of the UCC applied to working interests in minerals. In that case a bank took an assignment of a working interest in a mineral lease and filed appropriate mortgage instruments in the real estate records but

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[101] *See supra* notes 92-102 and accompanying text (discussion of Mississippi mortgage law in the mineral lease context).

[102] MISS. CODE ANN. § 75-9-306 (1972).

[103] Many mineral deeds and leases contain express provisions obligating the grantee or lessee to compensate the surface owner for all damages to the surface estate resulting from mineral exploration and development. The measure of these "surface damages" is the difference between the fair value of crops destroyed had they matured to harvest less costs that would reasonably be incurred in cultivation, harvesting, and marketing. 1 H. WILLIAMS & C. MEYERS, OIL & GAS LAW § 218.11 (1981).

[104] *See supra* notes 99 and 100, and accompanying text.

[105] 214 Kan. 45, 521 P.2d 254 (1974).

made no UCC filings. When a judgment creditor attempted to levy on the working interest, the bank argued that it had priority because of its mortgage filing.[106] The court ruled that, under Kansas law, a working interest in an oil and gas lease is an interest in real property and is excluded from the scope of Article 9 by its own terms.[107]

Since Mississippi, like Kansas, is an ownership-in-place jurisdiction,[108] the *Ingram* rule should be applied by Mississippi courts as well.[109] Further, if working interests[110] are not within the coverage of Article 9 of the UCC, other interests derived from a mineral lease, such as an overriding royalty interest,[111] a net-profits interest,[112] or a right to receive production payments,[113] may be excluded from coverage as well. Commentators

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[106] 214 Kan. 45, 521 P.2d at 255-58.

[107] *Id.*, 521 P.2d at 259-60.

[108] *See, e.g.*, Humble Oil & Ref. Co. v. Martin, 298 F.2d 163, 165 (5th Cir. 1961) (Mississippi is an ownership-in-place jurisdiction), *cert. denied*, 371 U.S. 825 (1962). *Compare Ingram*, 521 P.2d at 257-59 (discussing Kansas case law dealing with the nature of an oil, gas, and mineral lease) *with* Richards v. Shearer, 145 Kan. 88, 64 P.2d 56, 58-59 (1937) (apparently adopting the ownership-in-place doctrine) *and* H. WILLIAMS & C. MEYERS, OIL AND GAS LAW § 203, 203.3 (rev. 1981) (Professors Williams and Meyers opining that Kansas is an ownership-in-place jurisdiction).

[109] *See* Chevron Oil Co. v. Clark, 432 F.2d 280, 286 (5th Cir. 1970) in which the Fifth Circuit Court of Appeals, citing Merrill Eng'g Co. v. Capital Nat'l Bank, 192 Miss. 378, 5 So. 2d 666 (1942), stated that "[u]nder Mississippi law it is established that a working interest in an oil well is realty." In *Merrill Eng'g Co.*, the Mississippi Supreme Court examined the nature of a royalty interest, not a working interest, but the court did say " '[w]e are clearly of the opinion that the grant of one-half of the royalties, rents and *income* from the oil is a grant of one-half of the oil in place' " Merrill Eng'g Co., 192 Miss. at 393, 5 So. 2d at 670 (emphasis added). A reasonable implication from this would be that a working interest in minerals is an interest in realty because the owner is entitled to income from those minerals that were "in place" at the time he acquired his interest.

[110] The owner of a "working interest" in minerals has the exclusive right to explore for and develop minerals in the subsurface estate. H. WILLIAMS & C. MEYERS, OIL & GAS TERMS 838 (5th ed. 1981).

[111] Although usage varies, an overriding royalty interest generally refers to any royalty carved out of a working interest in addition to the royalty payable to the landowner. *See* H. WILLIAMS & C. MEYERS, *supra* note 103, at 518-19. A royalty is any share of production free and clear of production costs. *Id.* at 656.

[112] This is a share of production stated in terms of net profits from operations conducted on the leasehold. *See id.* at 457.

[113] A right to receive production payments is a right to receive a specified share of production from a specific leasehold or parcel of land free of production costs, which terminates upon receipt of a specified sum. *See id.* at 493.

who argue that the right to receive production payments should be within the coverage of Article 9 of the UCC point out that such a right is merely a contractual right to proceeds from the sale of severed minerals—in short, personalty.[114] Similarly, they point out that those rights are in the nature of a sale of inventory and accounts, a type of transaction that is specifically covered by Article 9.[115] These commentators advocate coverage of net-profits interests on grounds that there is no real distinction between net-profits interest and right to receive production payments in that both are "general intangibles," which are specifically covered by Article 9.[116]

Once minerals are extracted, the UCC does come into play because extracted minerals are classified as "goods," and liens on goods are expressly covered by the UCC. A lessee-operator seeking to secure funds to finance his operations may execute a security agreement covering all of his inventory, accounts, and equipment, as well as any proceeds from production. When oil, gas, and other minerals are extracted from the ground, they are classified as "inventory" because they are goods held for sale in the ordinary course of business.[117] When production is delivered—either to the pipeline or some other purchaser under an oil or gas purchase contract—an "account" is created since the operator, as a seller, receives a "right to payment for goods sold . . . which is not evidenced by an instrument or chattel paper."[118] Finally, when the operator is paid for the delivery of the oil and gas, the money submitted by the purchaser is "cash proceeds," which also is subject to Article 9 of the UCC.[119]

A lien governed by the UCC also may arise pursuant to an

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[114] B. CLARK, THE LAW OF SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE ¶ 13.2[3] (1980).

[115] Ryan, *Effect of the Uniform Commercial Code on Oil and Gas Transactions*, 18 INST. ON OIL & GAS L. & TAX'N 416 (1967).

[116] B. CLARK, *supra* note 114, at ¶ 13.2[4]. *But see* 2 H. WILLIAMS & C. MEYERS, OIL & GAS LAW § 424.1 (1981) (Professors Williams and Meyers acknowledging early case law treating a net-profits interest as a contract right, but stating their preference for its being treated as realty). *See also* MISS. CODE ANN. § 75-9-106 (1972) (definition of "general intangibles").

[117] *See* MISS. CODE ANN. § 75-9-109(4) (1972).

[118] *See id.* § 75-9-106 (1972).

[119] *See id.* § 75-9-306 (1972).

operating agreement executed by the owners of the working interests in a unit. The typical operating agreement requires each non-operator to contribute a specified share of the costs incurred by the operator in exchange for receiving a pro rata share of the production. To secure the obligation to contribute a share of the costs, these agreements commonly provide for an Article 9 lien against the production proceeds payable to the non-operator. This lien constitutes an "account" under Article 9.

Under the UCC, a lien against personalty cannot be enforced against third parties until a security interest in the property is "perfected."[120] As a general rule, unless the collateral is in the possession of the secured party, a financing statement must be filed in the appropriate place to perfect the security interest.[121] The place for filing depends upon the type of security, or "collateral," involved. If the collateral is minerals (including oil and gas) or fixtures, filing should be in the office where a mortgage on the real estate would be filed or recorded.[122] Otherwise, there generally should be a central filing with the Secretary of State, as well as a local filing in the office of the chancery clerk of the county where the debtor's place of business is if he has but one place of business, or, if he is a resident but has no place or business then in the county where he resides.[123]

As a general rule, a filed financing statement is effective for only five years unless a continuation statement is filed prior to the end of the five-year period.[124] Therefore, to determine if an interest is encumbered by a UCC lien, an examiner would need to check both the UCC records on file in the office of the chancery clerk of the county where the land is located, and the records in the office in the Secretary of State for filings made within five years prior to the date of the title examination.

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[120] *See* MISS. CODE ANN. § 75-9-203 (1972).

[121] *See id.* § 75-9-302 (1972).

[122] *Id.* § 75-9-401(1)(b) (Supp. 1983).

[123] *Id.* § 75-9-401(1)(c) (Supp. 1983). In the rare instance that a lien arising in an oil and gas transaction is secured by consumer goods, the place to file the financing statement is in the office of the chancery clerk in the county of the debtor's residence. If the debtor is not a resident of the state, the financing statement must be filed in the office of the chancery clerk of the county where the goods are located. *Id.* § 75-9-401(1)(a) (Supp. 1983).

[124] *Id.* § 75-9-403(2) (1972).

In regard to perfection of security interests, two things should be noted. First, as a general rule, a security interest continues in the "proceeds" of the collateral, that is, "whatever is received upon the sale, exchange, collection or other disposition of collateral."[125] Second, a buyer in the ordinary course of business takes free and clear of the security interest, even though it is perfected and even if the buyer knows of its existence.[126] This policy protects a buyer in the ordinary course of business who purchases from inventory, while still protecting the secured party since the security interest is transferred to the proceeds received by the debtor from the sale of the inventory collateral. Therefore, when minerals are sold to a purchaser in the ordinary course of business, the lender's security interest in those minerals is cut off, although it continues with respect to the proceeds received from the sale.[127]

When there are neither any outstanding obligations of the debtor to the secured party nor any commitment of the secured party to make advancements, incur obligations, or otherwise give new value to the debtor, then the debtor may require the secured party to send a termination statement to the office in which the financing statement was filed indicating that a security interest is no longer claimed under the financing statement.[128] A secured party may also, by the execution of a statement, release all or a part of the collateral to which a security interest is attached.[129]

VI. Construction Liens

At common law, liens were normally perfected by possession of the property—for example, a repairman kept possession of the debtor's property until the repairs had been paid for.[130] Today, statutes provide for a number of liens that do not require

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[125] Miss. Code Ann. § 75-9-306 (1972).

[126] *Id.* § 75-9-307(1) (1972).

[127] *See id.* § 75-9-306 (1972).

[128] *Id.* § 75-9-404 (1972).

[129] *See id.* § 75-9-406 (1972).

[130] *See id.* § 85-7-131 (Supp. 1983). *See generally* Brown, *Mechanics' Liens: An Interpretation of Section 356 As Amended*, 37 Miss. L.J. 203, 206-11 (1966) (discussion of history of mechanics' liens in Mississippi).

possession of the property for perfection. Section 85-7-131 of the Mississippi Code subjects every structure on real property to liability for any debt for labor done, materials furnished, or architectural engineer's, surveyor's, or contractor's services involved in the construction of a structure on that land.[131] This lien is available to construction laborers, materialmen, contractors, architects, engineers or surveyors, and it is commonly referred to as a "construction lien" or "mechanic's lien."[132] Section 85-7-131 was amended recently to specifically include a lien in favor of operators of oil and gas wells upon the interest of each non-operator mineral owner for a proportionate share of the costs of drilling. The construction lien not only covers the structure, it also covers both surface and subsurface estates in the real property to which the structure is affixed.[133]

To perfect a construction lien generally, the lienor may either file a petition instituting suit on the lien[134] with the proper court *or* file a copy of the contract under which the lien

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[131] MISS. CODE ANN. § 85-7-131 (Supp. 1983). If the person requesting the alteration or repair of a building is a tenant, guardian or other person who is not the owner of the land, the lien runs only to the structure and the estate of the tenant in the lands. *Id.* § 85-7-137 (1972).

[132] MISS. CODE ANN. § 85-7-131 (Supp. 1983). *See generally* Comment, *Mississippi Law Governing Private Construction Contracts: Some Problems and Proposals*, 47 MISS. L.J. 437, 439 n.9 (1976) ("construction lien" and "mechanic's lien" may be used interchangeably).

[133] MISS. CODE ANN. § 85-7-131 (Supp. 1983). There is a distinction in the statute as to the amount of land covered by the lien, depending upon whether the structure is in a city or not. If the structure is situated on a parcel of land in a city, then the lien extends to the entire lot of land upon which it stands. If, on the other hand, the structure is in the country, the lien extends to and covers up to one acre of the land upon which the structure is situated. If the structure is an oil or gas well, the lien extends to the non-operator's interest in the mineral estate, as well as the fixtures and equipment in the producing unit. *Id.*

[134] MISS. CODE ANN. § 85-7-131 (Supp. 1983). A suit to enforce the construction lien must be commenced before a justice court judge or in the circuit court of the county in which the property is located within twelve months after the time when the money claimed becomes due and payable. *Id.* §§ 85-7-141, -265 (1972). A judgment in favor of the holder of the lien against the person owning the property may be rendered, followed by a special order for the sale of the property for the payment of the judgment. The land and structure are sold as in any other case of land levied on for debt, and the purchaser at the execution sale acquires the same interest or estate in the land as the owner had at the time the lien attached, subject to any prior encumbrances. *Id.* § 85-7-151 (1972). Of course, in the event of a judicial sale pursuant to these provisions, only the structure and the land to which the lien attached would be sold.

arose [or notice thereof] in the office of the chancery clerk wherein the land lies.[135] Section 85-7-131, however, seems to permit perfection of the lien on oil and gas structures *only* by filing a notice in the office of the chancery clerk and not by the filing of a suit on the lien. In either case, until perfected according to the statute, the lien is effective only between the lienor and lienee, and it is not effective as to purchasers or encumbrancers for value without actual notice.[136] Finally, the statutes limit the lien's duration to twelve months, whether filed or not.[137]

A. Application

What curative measures are necessary to insure that an oil, gas, and mineral lease obtained from a mineral owner, who has had a construction lien filed against him, will be unencumbered by the lien? First, the title examiner should check the date on which the construction lien was filed. As noted above, a construction lien is valid for only twelve months, within which an action must be commenced. If twelve months have elapsed and no suit has been filed, the lien is unenforceable, and a lease may be obtained free and clear of the lien.[138] Furthermore, if the

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[135] *Id.* § 85-7-131 (Supp. 1983). The chancery clerk is required to maintain in his office a book entitled "Notice of Construction Liens" in which notices of these liens are recorded. It is interesting to note that although section 85-7-131 of the Mississippi Code requires only that the notice be filed in order to be effective, section 85-7-133 states that the lien "shall not take effect unless and until some notification thereof shall be filed *and* recorded in said book showing a description of the property involved, the name of the lienor or lienors, the date of filing, if and where suit is filed, and if and where the contract is filed or recorded. *Id.* § 85-7-133 (1972) (emphasis added).

[136] The Mississippi Supreme Court has held that actual knowledge of recent construction on a parcel of land is not sufficient to constitute "notice" of an unrecorded contract or claim of a materialman. *See* Jones Supply Co. v. Ishee, 249 Miss. 515, 524-25, 163 So. 2d 470, 473-74 (1964) (knowledge that debtor's home was recently constructed and that debtor was in arrears in payments to mortgagor at the time the mortgage was entered into did not impute "notice" of unrecorded materialman's contract); Walker v. Macon Creamery Co., 165 Miss. 121, 127-28, 146 So. 442, 444 (1933) (advancement of money secured by a deed of trust specifically for construction of a building on the land standing as security did not constitute "notice" of materialman's unrecorded contract).

[137] Miss. Code Ann. § 85-7-141 (1972).

[138] *See* King v. Hawkins, 209 So. 2d 190, 191 (Miss. 1968) (suit brought over two years after filing of the mechanic's lien against a personal residence held barred by twelve-month statute of limitations). The twelve-month statute of limitations has been held inapplicable to actions against personalty. Jay Indus., Inc. v. Powell, 220 Miss. 372,

money has been due for some time prior to the filing of the lien notice, the lien may become unenforceable less than twelve months from the date it was filed. If the lienor has filed his statutory notice prior to the contemplated execution of a mineral lease on the same property, the lessee should obtain a subordination from the lienor or pay the debt as part of the consideration of the lease and obtain a cancellation of record of the lien.

If, however, the construction lien is against a mineral owner who has already validly executed an oil, gas, and mineral lease, which was properly filed of record prior to the filing of the construction lien, what effect does the lien have on the validity of the lease? Since the lease was filed prior in time to the construction lien, it will be superior to the lien. Thus, unless the lessee had actual knowledge of the lien, the lien should not encumber the lease. In the event, however, the lessee desires to obtain a ratification, renewal, extension or other modification of the lease, the same curative measures will need to be taken as discussed above.

If a lessee's interest in a mineral lease is encumbered by a construction lien, all assignments of the interest executed after the lien was filed will be subject to the lien. The assignee of a leasehold interest encumbered by a construction lien must resort to the same curative measures as the original lessee—release, satisfaction, or subordination of the lien.

VII. Equitable Liens

Equitable liens[139] are another potential encumbrance on the title to real property of which the title examiner should be aware. Normally an equitable lien is created by a contract in which the parties, either expressly or by implication, impress

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379, 71 So. 2d 193, 196 (1954).

[139] The Mississippi Supreme Court defined "equitable lien" in Pincus v. Collins, 198 Miss. 283, 22 So. 2d 361 (1945):

> Simply defined, an equitable lien, when created by contract is the right by which a creditor is entitled to obtain satisfaction of his debt by resort to specified property belonging to the debtor, and no particular form of expression is necessary in such a contract so long as it is clear that the debtor intended to create the encumbrance.

Id. at 287-88, 22 So. 2d at 362.

particular property with a lien for the payment of a debt or a claim. An example is *Pincus v. Collins*,[140] in which a building contractor expressly provided in a contract that he would retain a lien on the building until he had been paid in full. The Mississippi Supreme Court held that the lien was an equitable lien on the property and not merely a construction lien since the parties expressly provided for the lien.[141] In *Mendrop v. Harrell*[142] the Mississippi Supreme Court held that subdivision covenants that run with the land may impress equitable liens on the land to secure payments due under the covenants for street and sidewalk improvements, if it is implied in the covenants that the charge will be a burden on the land.[143]

As a general rule, equitable liens are impressed upon property under the doctrines of estoppel, unjust enrichment, or unconscionable retention of property of another.[144] In *Jim Walter Corp. & Mid-State Homes, Inc. v. Gates*,[145] the Mississippi Supreme Court applied the doctrine of unjust enrichment to impose an equitable lien against the real property of an owner who allowed a home to be built thereon by a contractor who had been purposefully misled by the owner's relative as to who held title to the realty.[146] In *Dobbs v. Bowling*,[147] the court applied the doctrine to impose an equitable lien when one party paid a real estate mortgage of another in reliance upon an oral promise to convey the property to the lender as security for repayment.[148] The Mississippi Supreme Court has refused, however, to impose an equitable lien when a promise given as consideration for a deed is too uncertain and indefinite to be enforced by such a lien, and money damages provide the aggrieved party adequate relief.[149]

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[140] 198 Miss. 283, 22 So. 2d 361 (1945).

[141] 198 Miss. at 287-88, 22 So. 2d at 362.

[142] 233 Miss. 679, 103 So. 2d 418 (1958).

[143] *Id.* at 690-91, 103 So. 2d at 424.

[144] *See* 51 AM. JUR. 2D *Liens* § 24 (1970) (stating the proposition and giving illustrative cases).

[145] 370 So. 2d 928 (Miss. 1979).

[146] *Id.* at 929-30.

[147] 339 So. 2d 985 (Miss. 1976).

[148] *Id.* at 987. *See also* Fletcher v. Nemitz, 186 So. 2d 232, 237 (Miss. 1966) (same).

[149] *E.g.*, Wilson v. Combs, 203 Miss. 286, 291, 33 So. 2d 830, 831 (1948) (unenforce-

A. Application

Although an equitable lien may arise by implication from the actions of the parties to a financing transaction, the more significant origin of an equitable lien, as far as an examiner of mineral titles is concerned, is implication from the express provisions of a written instrument. Although the title examiner may be reasonably unaware of the dealings between a prospective mineral lessor or assignor and third persons, the title examiner is charged with full knowledge of all provisions and statements contained in all instruments in the chain of title, whether or not recorded,[150] and with knowledge of all attendant facts discoverable upon reasonable inquiry regarding the contents of those instruments.[151] The title examiner must check all instruments in the chain of title for provisions that might give rise to an equitable lien.

An equitable lien will encumber any interest in the property covered thereby that was created subsequent to the equitable lien, except as to innocent purchasers or encumbrancers with neither constructive notice nor actual knowledge of the circumstances giving rise to the creation of the lien. If an oil, gas, and mineral lease were to be executed subsequent to the date the lien was created and the lessee had constructive notice or actual knowledge of the circumstances giving rise to the lien, then the

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able due to vagueness and uncertainty); Hall v. Scott, 201 Miss. 540, 544, 29 So. 2d 640, 641 (1947) (damages adequate relief).

[150] *See, e.g.*, Baldwin v. Anderson, 103 Miss. 462, 60 So. 578, 580 (1913) (subsequent purchaser had constructive notice of grantor's payment of shockingly inadequate consideration because deed into grantor recited consideration *in full*; sale set aside); Chew v. Calvert, 1 Miss. (1 Walker) 54, 61 (1818) (the purchaser must examine "every essential document in [his] chain of title"). *See generally* Note, 53 MISS. L.J. 533, 538 n.21 (1983) (discussion of *Baldwin v. Anderson*).

[151] In Gulf Ref. Co. v. Travis, 201 Miss. 336, 29 So. 2d 100, *suggestion of error overruled*, 201 Miss. 379, 30 So. 2d 398 (1947), the Mississippi Supreme Court held that a mineral lessee had constructive notice of a prior unrecorded conveyance by the lessor because "the information carried by the documents [available to the lessee] was sufficient to put [lessee] on inquiry, which, if diligently pursued by him . . . would have led him to full knowledge. . . ." *Id.* at 370, 29 So. 2d at 104. In *Gulf Ref. Co. v. Travis*, the lessee failed to ask the tenants of the surface estate the true ownership of the property. *Id.* at 364, 29 So. 2d at 101-02. The court found that the tenants knew the true ownership and would have informed Gulf Refining Co. of the undisclosed conveyance. *Id.* at 363-70, 29 So. 2d at 101-03.

lease would be subject to the equitable lien. The remedies available to remove the encumbrance of the lien are the same as available with respect to deeds of trust—subordination of the lien to the lease, release of the lands covered by the lease from the lien, or satisfaction of the underlying debt and cancellation of the lien.

VIII. Federal Tax Liens

A. General Federal Tax Liens

The Internal Revenue Code of 1954 imposes a general lien for all unpaid federal taxes, interest, and penalties. The lien attaches automatically, without notice, to all real or personal property rights belonging to the delinquent taxpayer.[152] The lien attaches at the moment the tax is assessed and it continues until all taxes, accrued interest and penalties have been paid or until the lien becomes unenforceable due to lapse of time.[153] Generally, a tax must be *assessed* within three years after a return has been filed,[154] but several exceptions to this rule exist. For example, in the event of a false return, a willful attempt to evade the tax laws, or the failure to file a return, taxes may be assessed and a proceeding commenced for the collection of the tax at any time.[155] If a return has been filed but a substantial amount of income (more than twenty-five percent of gross income) has inadvertently been omitted from the return, then the Internal Revenue Service (IRS) may assess the tax and commence a proceeding for its collection within six years from the date the return was filed.[156] The same is true with respect to an inadvertent omission of twenty-five percent or more of the gross estate when gift and estate taxes are concerned.[157] This six year limitation applies only in situations in which the omission was inadvertent. If the omission was willful, or with an intent to evade the tax

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[152] I.R.C. § 6321 (1976).
[153] I.R.C. § 6322 (1976).
[154] I.R.C. § 6501(a) (1976).
[155] *Id.* § 6501(c) (1976).
[156] *Id.* § 6501(e)(1) (1976).
[157] *Id.* § 6501(e)(2) (1976).

laws, there is no limitation.[158]

With respect to all other inadvertent omissions, the IRS must assess the deficiency within three years of the date the erroneous return was *actually* filed, and must institute a proceeding for collection of those taxes within six years of the assessment unless the limitation period is suspended pursuant to section 6503 or by agreement between the taxpayer and the IRS.[159] The lien reaches all of the taxpayer's property whether owned at the moment of attachment or thereafter acquired.[160] Though valid as between the federal government and the taxpayer from the moment of attachment, the lien is not effective against a purchaser, mechanic's lienor, mortgagee, or judgment creditor unless a notice of the tax lien is recorded pursuant to the state recording statute.[161] Under Mississippi law, notices of liens for taxes payable to the United States, and certificates discharging such liens, must be filed in the office of the chancery clerk of the county or counties within which the property subject to the liens is situated.[162] The chancery clerk is required to maintain a separate book within which to record federal tax liens.[163] A notice of a general federal tax lien is valid for an indefinite period of time so long as it is periodically refiled.[164]

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[158] I.R.C. § 6501(c)(2) (1976).

[159] I.R.C. §§ 6501(a), 6502(a)(1976). Section 6503 provides that the statute of limitations may be suspended in the following situations: (1) when the I.R.S. is suspended from making assessment or collection by court order, (2) when the assets of the taxpayer are in the control or custody of a court, (3) while the taxpayer is outside of the United States, (4) when the I.R.S. has granted the taxpayer an extension of time for payment of certain taxes, and (5) when the I.R.S. has wrongfully seized the property of third persons. *Id.* § 6503 (1976 & Supp. V 1981).

[160] *E.g.*, Rice Inv. Co. v. United States, 625 F.2d 565, 568 (5th Cir. 1980) (after-acquired property is reached by federal tax lien).

[161] I.R.C. § 6323(a), (f) (1976).

[162] MISS. CODE ANN. §§ 89-5-47 to -51 (1972).

[163] *Id.* § 89-5-49 (1972).

[164] I.R.C. § 6323(g)(3) (1976). A notice of a general federal tax lien is valid for six years, but it may be refiled within a one-year period ending thirty days after the sixth anniversary of the date the tax was assessed. The lien may also be refiled every six years; the refiling must be during the last year of the six-year period. *Id.* If the notice is not refiled within the last year of the six-year period, it is invalid as to all purchasers taking prior to the time it is actually refiled, but is superior to all purchasers taking subsequent to the latest filing. *See* W. PLUMB, JR., FEDERAL TAX LIENS 70 (3d ed. 1972).

(i) Application

As noted above, the general federal tax lien attaches to all after-acquired property of the delinquent taxpayer. Therefore, in checking records for title examinations, federal tax liens should be checked prior to the date the owner in the chain of title acquired an interest in the property in question.

If the lien is not barred by the statute of limitations or if the taxpayer and the IRS have entered into an agreement to suspend the running of the statute of limitations, then remedies for curing the encumbrance of a general federal tax lien must be sought. The title examiner may obtain a release of the lien or discharge of the property from the District Director of the IRS.[165] Alternatively, the lien may be subordinated to the lease.[166] Depending upon the speculative value of the particular mineral estate, an arrangement may be worked out for the payment of the taxes by the lessee or assignee prior to the conveyance or assignment of the mineral estate, with reimbursement for this payment to be made out of production payments.[167]

Occasionally, a property owner will have the same name as a delinquent taxpayer against whom a tax lien has been filed. The simplest method to cure this confusion is to obtain an affidavit specifically identifying the property owner and distinguishing him from the delinquent taxpayer. A more conclusive approach is to have the IRS issue a "certificate of Nonattachment of Lien," by which the IRS acknowledges that the lien does not pertain to the property of the owner in question.[168]

B. Federal Estate and Gift Tax Liens

The Internal Revenue Code imposes a lien in favor of the United States on the gross estate of a decedent as security for the payment of any unpaid estate tax.[169] The Code also creates a similar lien on all property transferred as a gift as security for

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[165] I.R.C. § 6325(a), (b) (1976).
[166] *Id.* § 6325(d) (Supp. V 1981).
[167] *See supra* note 113 (discussion of production payments).
[168] I.R.C. § 6325(e) (1976).
[169] *Id.* § 6324(a)(1) (1976).

any unpaid gift taxes.[170] These liens arise on the date of death or the date the gift is made[171] and continue for ten years or until the liability is paid in full or the lien becomes unenforceable.[172] Although neither the estate tax nor the gift tax lien are required to be filed of record to be enforceable, these liens will not be effective against innocent purchasers without actual knowledge unless they have been properly filed. The Code provides that federal estate and gift tax liens are divested from the conveyed property and are transferred to *all* other property held by the beneficiary or donee[173] when the conveyance is to any innocent purchaser for value.[174]

(i) Application

It is possible for a mineral interest to be encumbered by a federal estate or gift tax lien even though it has neither passed through an estate nor ever been a gift, because federal estate and gift tax liens are transferred to the property of the donee or beneficiary. A subsequent innocent purchaser for value of property subject to such a transferred estate or gift tax lien, however, should take the property unencumbered by the transferred tax lien unless the lien had been properly filed of record.[175] Therefore, as a precautionary measure, the title examiner should, if any owner in the chain of title has died within ten years from

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[170] I.R.C. § 6324(b) (1976).

[171] *Id.* § 6324(a)(1), (b) (1976).

[172] *See supra* notes 160-64 and accompanying text (discussion of scope and effect of lien).

[173] I.R.C. § 6324(a)(2), (b) (1976).

[174] One commentator has suggested that the only way to be certain that there is no federal estate tax lien against property is to examine the title to all property owned at any time within the last ten years by all owners in the chain to determine whether a federal estate tax lien has transferred to the property owned by a beneficiary or donee. Since abstracts generally will not disclose transactions of an owner (who may have been a donee or beneficiary) not directly affecting the subject property, the commentator recommended that title examiners make an exception for possible gift or estate tax liens in the title opinion, unless an independent search has been made revealing that there have been no estate or gift transfers made to any person in the chain of title within the past ten years. *Proposed Title Examiners' Advisory No. 1*, 37 Mo. B.J. 172, 175 (1981). This concern seems undue, because the purchaser would be an innocent purchaser for value so long as no lien had been filed of record.

[175] I.R.C. § 6324A(a) (Supp. V 1981).

the date of the title examination, require proof that the full estate tax due and owing by the estate has been paid, or require that the property be released or discharged from any federal tax lien by the District Director of the IRS.[176]

C. *Special Federal Tax Liens*

(i) *Deferred Payment Estate Tax Lien*

The Internal Revenue Code provides for the creation of a lien in favor of the United States for estate taxes, interest, penalties and costs, which are deferred pursuant to section 6166 of the Code.[177] This section allows the taxpayer, provided certain criteria are met, to defer payment of certain estate taxes when the estate primarily consists of interests in a closely held business.[178] The lien is created by an agreement between the IRS and the executor of an estate who desires to defer payment of the estate tax. This deferral must be agreed to by all persons having an interest in any property to which the lien is to attach. This lien is required to be filed in the same manner as the general federal tax lien. Once filed, however, the lien continues in effect until the liability is satisfied or becomes unenforceable due to lapse of time, and does not have to be refiled every six years to remain effective.[179] The tax lien for deferred payment of estate taxes arises on either the date the executor is discharged from liability under section 2204 or the date the notice of the lien is properly filed by the IRS, whichever is earlier. The lien is effective against subsequent purchasers and encumbrancers only from the time it is properly filed of record.[180]

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[176] I.R.C. § 6325(a), (b) (1976).

[177] *Id.* § 6166 (1976 & Supp. V 1981). Until repealed effective December 31, 1981, section 6166A had allowed decedent's estates to elect to pay estate tax liability in ten equal annual installments, the first of which was due with the filing of the return. The estate was then obliged to pay total interest accrued plus one-tenth of the liability annually thereafter. *See* I.R.C. § 6166A (1976), *repealed by* Economic Recovery Tax Act of 1981, § 422(d), 95 Stat. 315 (1981).

[178] I.R.C. § 6166(a) (1976).

[179] *See* R. STEPHENS, G. MAXFIELD & S. LIND, FEDERAL ESTATE AND GIFT TAXATION ¶ 4.04 [1],[6] (5th Prof. ed. 1983) [hereinafter cited as R. STEPHENS].

[180] *Id.*

(ii) Special Use Valuation Recapture Tax Lien

Section 6234B of the Internal Revenue Code creates a lien in favor of the United States upon all "qualified real property" that has been specially valued pursuant to section 2032A. Section 2032A allows the decedent's estate to elect to have the "qualified real property" included in the gross taxable estate at a "special use" valuation rather than at the traditional "highest and best use" valuation.[181] To qualify for the election, the estate must be able to show that the particular real property had been put to a "qualified use" for a certain period of time prior to decedent's death and that the real property passed to a "qualified heir."[182] Generally, if the "qualified use" is discontinued or the "qualified real property" passes into the hands of someone who is not a "qualified heir" within ten years of decedent's death, section 2032A(c) imposes a recapture tax. The recapture tax essentially is the difference between the actual estate tax liability of the estate and what it would have been had the particular realty been included in the gross taxable estate at its "highest and best use" valuation.[183] Interest accrues on the recapture tax only if the tax is not timely paid or if a special election is made by the taxpayer to have interest accrue retroactively from the due date of the previously filed estate tax return.[184] Although the lien for special valuation recapture tax arises when an election is filed under section 2032A and continues until the liability is satisfied or becomes unenforceable due to lapse of time, the lien must be filed of record before it will affect subsequent purchasers for value. The lien does not have to be refiled to remain effective.[185]

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[181] I.R.C. § 2032A(b) (1976 & Supp. V 1981).

[182] *Id.* § 2032A(c) (1976 & Supp. V 1981).

[183] *See id.* § 2032A(c)(2) (Supp. V 1981) (special use valuation recapture tax due six months from date of disposition or cessation of "qualified use"); *id.* § 1016(c)(5) (interest is computed from date original estate tax return due to be filed if taxpayer elects special benefits of I.R.C. § 1016(c) (Supp. V 1981)); *id.* § 6075(a) (1976) (estate tax return due to be filed within nine months of date of death); *id.* § 6601 (1976 & Supp. V 1981) (interest generally accrues from last date prescribed for payment). *See generally* R. STEPHENS, *supra* note 180, ¶¶ 4.04 [9] [A], 4.04 [14] (background discussion).

[184] I.R.C. § 2032A(a) (1976). *See supra* notes 160-64 and accompanying text (discussion of scope and effect of lien).

[185] I.R.C. § 6324B(b), (c)(1) (1976 & Supp. V 1981).

(iii) Generation-Skipping Transfer Tax Lien

Another special tax lien that is created in favor of the federal government by section 2603(b), attaches to property transferred pursuant to a generation-skipping transfer.[186] The lien for generation-skipping transfer tax[187] arises at the time a generation-skipping transfer is made and continues until the tax is paid in full or the tax liability becomes unenforceable by lapse of time or the tax is discharged.

The Internal Revenue Code does not specifically require that the generation-skipping transfer tax lien be filed of record to be effective against innocent purchasers and encumbrancers. The general common law rule, however, is that an unrecorded lien is junior in priority to a subsequent purchaser or encumbrancer for value without notice. Although no cases on point have been found, it has been suggested that the lien should be subject to the common law rule since the Code makes no provision concerning the priority of the lien.[188]

If the title examiner has cause to believe that the property

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[186] A generation-skipping transfer is a gratuitous transfer of property, usually to a testamentary trust, which allows the transferor to provide benefits to more than one generation of beneficiaries through the use of successive interests. For example, a person might establish a testamentary trust granting a life income interest to his child and a remainder to any grandchildren. Before enactment of section 2601, estate taxes were payable upon the death of the transferor and not upon the death of the life tenant; any intervening appreciation in the corpus escaped estate taxation. Of course, estate taxes were payable upon the death of the grandchildren—remaindermen, but the intermediate generation "skipped" payment of estate taxes altogether. The result was unchanged if the initial transfer was by intervivos gift rather than by will. *See* I.R.C. § 2611 (1976) (defining "generation-skipping transfer"). *See generally* 34A Am. Jur. 2d ¶ 46,051 (1984) (background discussion).

[187] The generation-skipping transfer tax is payable upon a "taxable distribution" from a generation-skipping trust or upon termination of the trust or a life estate. In basic terms, a "taxable distribution" is any distribution of corpus property to the remainderman during the existence of a generation-skipping trust made pursuant to a limited power of appointment. The tax is a percentage of the fair value of the property distributed or a percentage of the fair value of the corpus or of the res in the case of a termination. *See* I.R.C. § 2613 (1976). The tax is a personal obligation of the distributee, but the tax cannot exceed the value of the property received. *Id.* § 2603(A) (1976). *See generally* 34A Am. Jur. 2d ¶ ¶ 46,102, 46,106 (1984) (background discussion).

[188] *Proposed Title Examiners Advisory No. 1*, 37 Mo. B.J. 172, 177 (1981). *But cf.* Rice Inv. Co. v. United States, 625 F.2d 565, 568 (5th Cir. 1980) (when the general federal tax lien was first enacted, the courts construed it to oust bona fide purchasers until Congress several years later expressly provided otherwise).

has been the subject of a generation-skipping transfer, he should require proof that any generation-skipping transfer tax due has been paid in full or require that the property be released from the lien by the District Director of the IRS, or make an exception in his opinion.

(iv) Application

Unless notice of a special tax lien has been filed with the chancery clerk, a title examiner may approve the title unless he has information to put him upon inquiry. If, however, a valid notice has been recorded and the lien has not expired by lapse of time, the examiner should require proof from the IRS that the tax has been fully paid. If the tax has not been paid, release or discharge from the lien should be obtained from the District Director of the Internal Revenue Service.

IX. State Tax Liens

A. State Income Tax Liens

The Mississippi Code imposes an income tax upon the net income of every resident individual, corporation, association, trust, estate and certain nonresidents.[189] The state tax commissioner has the authority to file a notice of tax lien for delinquent income taxes, penalties, and interest in the office of the circuit clerk, who must enroll the liens in the judgment roll. The lien is valid from the date notice is filed against subsequent mortgagees, pledgees, trustors, purchasers, and judgment creditors. The lien attaches to all real and personal property rights belonging to the taxpayer and has the same force and effect as an enrolled judgment of a court.[190]

If a state income tax return has been filed, the commissioner must bring an action for any deficiency within three years

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[189] Miss. Code Ann. § 27-7-5 (Supp. 1983).

[190] *Id.* § 27-7-55 (1972). The significance of giving the state income tax lien the same effect as a recorded judgment lien is that the state tax lien itself can serve "as authority for the issuance of writs of execution, writs of attachment, writs of garnishment or other remedial writs." *See id.*

from the date the return was due to be filed. If no return was filed or if the return filed was false or fraudulent with intent to evade the tax law, the commissioner may institute an action for collection of the tax at any time within six years.[191] The statutes oblige the state tax commissioner to give written notice of the delinquency within the statutory period.[192] If the taxpayer fails to seek either administrative appeal or judicial review within thirty days of receipt of the delinquency notice, the commissioner is authorized to file notice of the lien and institute execution procedures.[193]

B. State Estate Tax Liens

The Mississippi estate tax due on estates of $175,625 or more[194] must be paid, unless otherwise agreed by the state tax commissioner, with the filing of the state tax return, which is due nine months from the date of death of the decedent.[195] If the state estate tax due from an estate of a decedent is unpaid within sixty days after it becomes due, the state tax commissioner may issue a warrant directing the sheriff of any county in which any property of the decedent is situated to levy upon and sell that property. The sheriff is required to file a copy of the warrant with the circuit clerk within five days after receiving it.

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[191] MISS. CODE ANN. § 27-7-49(1) (1972). *Compare id.* § 27-7-49(4)(1972) (three-year examination period limitation does not apply "in the case of a false or fraudulent return with intent to evade tax") *with id.* § 27-3-41 (1972) (requiring the state tax commissioner to assert *all* income tax claims other than ad valorem tax claims within six years from due date of tax).

[192] *Id.* § 27-7-53 (Supp. 1983).

[193] *See id.* §§ 27-7-51 to -55 (1972 & Supp. 1983).

[194] For purposes of determining a decedent's taxable estate, deductions are allowed for items such as funeral and administration expenses, unpaid mortgages, charitable bequests and casualty or theft losses not compensated by insurance or otherwise. MISS. CODE ANN. § 27-9-9 (1972). After these deductions have been taken, another deduction is allowed in the case of a resident decedent. For decedents dying after 1981, that deduction is in the amount of $175,625. *Id.* § 27-9-11 (Supp. 1983). No Mississippi estate taxes will be owed if these deductions result in a negative net value in the estate. *Id.* Furthermore, since MISS. CODE ANN. § 27-9-5 (Supp. 1983) provides that the Mississippi estate tax liability shall not be less than the state death tax credit allowable under I.R.C. § 2011 (1983) against the federal estate tax liability, there should be no federal estate tax liability for a taxable estate of $175,625, and therefore, no state death tax credit to generate state estate tax liability.

[195] MISS. CODE ANN. § 27-9-27 (Supp. 1983).

When enrolled in the judgment roll, the warrant becomes a lien upon all property of the estate in the same manner as a duly enrolled judgment.[196] The lien continues in effect for four years from the date of filing if an estate tax return has been filed. If no estate tax return has been filed, the lien remains in full force and effect for ten years from the due date of the return.[197] The state tax commissioner may issue a certificate of waiver releasing any or all property from the lien if he is satisfied that the tax liability of the estate has been fully discharged or payment has been appropriately provided.[198]

C. Severance Tax Liens

Mississippi imposes upon every person engaged in the business of producing oil or natural gas a severance tax of six percent of the value at the wellhead of all oil or gas produced.[199] The Mississippi Code imposes complementary liens in favor of the state to secure the payment of these severance taxes. The oil severance tax lien attaches only to the oil produced, while the gas severance tax lien attaches to the property from which the gas was produced.[200]

The person on whom the severance tax is imposed—the person engaged in the business of producing oil or natural gas—is obliged to file a return on a monthly basis.[201] Generally, an action for the collection of severance taxes must be commenced within thirty-six months after the severance tax return is

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[196] MISS. CODE ANN. § 27-9-31 (1972).

[197] *Id.* § 27-9-35 (1972).

[198] *Id.* §§ 27-9-35, -41 (1972).

[199] *Id.* § 27-25-503 (1972) (severance tax on oil production); *id.* § 27-25-703 (1972) (severance tax on natural gas production). A combination severance-sales tax of five percent of the gross proceeds of sales or the value of the minerals produced is assessed against every person engaged in the business of mining, quarrying, drilling or otherwise producing limestone, sand, gravel, or other minerals or natural resource products except timber, oil, natural gas or salt. *Id.* § 27-65-15 (Supp. 1983).

[200] MISS. CODE ANN. § 27-25-707 (1972) provides that the tax lien created to secure payment of natural gas severance taxes "constitute[s] a first lien upon the property from which the gas was produced." Section 27-25-509 (1972), however, speaks of the lien to secure payment of oil severance taxes attaching only to the oil produced, rather than the land. That section further states that the lien applies to such oil "in the hands of the original producer, or any purchaser of such oil in its unmanufactured state or condition."

[201] *Id.* § 27-25-519 (1972) (oil); *id.* § 27-25-717 (1972) (gas).

filed.[202] If the return is fraudulent or if no return is filed, however, the state apparently may institute an action to collect the tax within six years of the due date of the return.[203]

The State Tax Commission commences an action by notifying the taxpayer of the alleged deficiency.[204] The taxpayer then must promptly seek administrative or judicial review.[205] If the taxpayer does not contest the commissioner's claim, the commissioner may file a notice of tax lien with the circuit court in the county in which the debtor's property is situated.[206] This notice filing operates the same as the filing of a judgment lien.[207]

D. Ad Valorem Tax Liens

The Mississippi Code imposes upon assessed property a tax lien for all state, county, and municipal ad valorem taxes.[208] The lien attaches on the date provided by statute for assessment, and continues for seven years thereafter.[209] The statutory date for assessment of ad valorem taxes is January 1 and the assessed taxes are due and payable on January 1 of the succeeding year. The ad valorem tax lien is entitled to preference over *all* judgments, executions, encumbrances, or other liens, whenever created.[210]

The Mississippi Code provides that ad valorem tax liens

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[202] *See* MISS. CODE ANN. §§ 27-25-509(1), -707(1) (1972) (oil and gas severance tax collection procedure governed by Mississippi sales tax law); *id.* § 27-65-42 (Supp. 1983) (thirty-six month statute of limitations for sales tax collections unless nonpayment is result of intent to evade tax).

[203] *See id.* § 27-3-41 (1972) (general tax collection statute of limitations providing that all collection actions be commenced within six years after due date).

[204] *Id.* § 27-65-35 (Supp. 1983) (commissioners must notify taxpayer of alleged delinquency by registered or certified mail).

[205] *Id.* §§ 27-65-45, -47 (1972).

[206] *Id.* § 27-65-57 (1972).

[207] *Id. See supra* note 190 and accompanying text.

[208] MISS. CODE ANN. § 27-35-1 (Supp. 1983).

[209] See *id.* § 27-3-41 (1972), which provides that the state tax commissioner must institute a proceeding for the assessment of property that has escaped taxation within seven years from the date the property originally could have been assessed, and that in *all* other actions the commissioner must commence the suit within six years after the cause of action accrues.

[210] *See id.* § 27-35-1 (Supp. 1983); *id.* § 27-41-1 (1972) (ad valorem taxes payable one-half on February 1, one-fourth on May 1, and one-fourth August 1).

may be assigned by county and city tax collectors to third parties who have paid the taxes due when the landowner authorizes or requests that such an assignment be made.[211] Any such assignment of the tax lien must be recorded in the office of the chancery clerk.[212] The assignee of the tax lien has the same rights in the property as does the tax collector—he may have the property sold after six months at public sale and receive out of the proceeds the amount of the taxes paid, plus any damages and costs.[213]

E. Mineral Documentary Tax Liens

An exemption from ad valorem taxes levied on or after January 1, 1947 has been granted as to all nonproducing oil, gas, and mineral interests.[214] In lieu of ad valorem taxes, a transfer tax known as the mineral documentary tax has been imposed on these exempted interests. This tax is due upon the filing and recording of any written instrument that creates, modifies, or reserves a mineral interest.[215] The mineral documentary tax is a lien upon the interest reserved or conveyed in the amount of the tax due, as well as any penalties or interest arising from failure to pay the tax promptly.[216]

The mineral documentary tax is paid to the chancery clerk who issues, as a receipt, documentary tax stamps to be affixed to the written instrument that conveys, modifies, or reserves an oil, gas, and mineral interest.[217] The amount of tax due per acre varies from three cents to eight cents depending upon either the

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[211] MISS. CODE ANN. § 27-47-1 (1972).

[212] *Id.* § 27-47-5 (1972).

[213] *Id.* § 27-47-13, -17 (1972).

[214] The exemption applies to nonproducing oil, gas, and mineral interests created after June 9, 1946. The same exemption applies to severed mineral interests created prior to that date if proper application has been made and documentary tax stamps have been purchased and affixed to the instrument of title. *Id.* § 27-31-73 (1972). MISS CODE. ANN. § 27-31-75 (1972) sets out the procedure by which an application for exemption of mineral interests created prior to January 1, 1947 may be made.

[215] *See* MISS. CODE ANN. §§ 27-31-77, -81 (1972). The tax is payable by any grantee, beneficiary or real party in interest in or under the lease, deed, transfer, conveyance or assignment of an oil, gas or mineral interest. *Id.* § 27-31-81 (1972).

[216] *Id.* § 27-31-79 (1972).

[217] *Id.* § 27-31-83 (1972).

term of the mineral or royalty interest purportedly conveyed or reserved or the term of the lease executed, assigned, or modified.[218]

F. Miscellaneous State Tax Liens

A number of other state taxes also constitute a lien upon the property of the person against whom the taxes are assessed. Among these are the corporation franchise tax,[219] state-wide privilege taxes,[220] drilling rig tax,[221] use taxes,[222] and sales taxes.[223]

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[218] The amount of the tax depends upon the duration of the interest conveyed or reserved. If the primary term of the interest expires within ten years from the date of the instrument, the tax is three cents per net mineral or royalty acre. If the primary term expires between ten years and twenty years from the date of the instrument, the tax is six cents per net mineral or royalty acre. If the primary term of the instrument exceeds twenty years or is a perpetual interest, then the tax is eight cents per net mineral or royalty acre. MISS. CODE ANN. § 27-31-79 (1972).

[219] *See* MISS. CODE ANN. § 27-13-29 (1972) (tax due is a lien upon all property of the corporation). The corporation franchise tax is a tax on foreign and domestic corporations doing business in Mississippi, and the amount of it is determined with reference to capital employed by the corporation in its Mississippi operations. *See id.* § 27-13-5 (Supp. 1983) (tax on domestic corporations); *id.* § 27-13-9 (Supp. 1983) (basis of valuation).

[220] *Id.* § 27-15-215 (1972) (tax due is a lien upon all property of the entity engaged in the subject privilege). The state-wide privilege tax is a tax imposed on specifically enumerated, identifiable commercial activities. *See id.* § 27-15-11 (1972). These taxes have very limited applicability, if any, to mineral estates because they presently apply for the most part to public utilities and insurance companies.

[221] MISS. CODE ANN. § 27-17-143(6) (1972) (tax due is a lien upon the drilling rig). The drilling rig tax is a local privilege tax imposed upon the owner or operator of a drilling rig for the privilege of drilling an oil or gas well. *Id.* § 27-17-143(2) (1972). The tax is in the amount of $1.01 per foot drilled up to 7000 feet and $4.21 per foot drilled thereafter. *Id.* § 27-17-143(3) (1972). The lien created under this statute attaches only to the drilling rig itself—not to the leasehold interest or to any oil, gas, or minerals produced. *Id.* § 27-17-143(6) (1972).

[222] *Id.* § 27-67-21 (1972) (use tax is a debt and a lien upon the property). A use tax is a tax on the privilege of using or consuming a particular tangible res. *See id.* § 27-67-3(i), (j) (Supp. 1983). The use tax is typically imposed on property that would be subject to the state sales tax except that the particular res was either bought outside the taxing state or merely leased for use in the taxing state for a period of time. *See, e.g.*, MISS. CODE ANN. § 27-67-5 (Supp. 1983) (providing for use tax on rental property); *id.* 27-67-7(a) (Supp. 1983) (providing a credit against the use tax in the amount of sales taxes paid another state).

[223] *Id.* § 27-65-41 (Supp. 1983) (sales tax due constitutes a lien upon all the property of the taxpayer). A sales tax is a tax imposed upon the privilege of engaging in the commercial sale or barter of specified goods and services. See *id.* § 27-65-3(f) (Supp. 1983)

Under the common law rules of priority, liens must be filed of record to be effective against a subsequent purchaser or encumbrancer for value who has no knowledge or notice of the lien. Presumably, if these liens are significant in a particular instance the common law rules of priority should be available to protect a lessee or assignee, since there are apparently no specific statutory provisions concerning the priority of these liens.

G. Municipal Special Assessments Liens

Municipalities in Mississippi may make special assessments against real property for improvements made by the city benefitting particular property,[224] such as streets, curbs, gutters, sidewalks, water systems, sewer systems, and drainage systems.[225] All or part of the cost of the improvements may be charged against the property benefited.[226]

The Mississippi Code requires notice by publication and a public meeting before an improvement is made and then again before the special assessment is made.[227] Upon confirmation of the special assessment by the municipality following the second public meeting date, the special assessments constitute a lien on the parcels of land upon which they are levied, and this lien is superior to all other liens except those for city, county, and state taxes.[228]

(defining "sales"); *id.* § 27-65-13 (1972) (coverage of the "sales" tax).

Mississippi provides for a sales tax in two areas significant in the oil and gas operations context. First, there is a hybrid severance-sales tax of five percent on severed minerals other than natural gas, oil, and salt. MISS. CODE ANN. § 27-65-15 (Supp. 1983). The lien securing payment of this hybrid tax attaches only to the minerals produced. *Id.; see also supra* note 199 and accompanying text (discussion of the hybrid minerals tax). The Mississippi Code also imposes a sales tax upon oil and gas well operators, consisting of a percentage of the amount by which a drilling contract price exceeds $10,000 for drilling, redrilling, and reworking operations. *Id.* § 27-65-21(2) (Supp. 1983). The lien securing payment of the drillers sales tax is imposed only upon the property of the driller. *Id.* § 27-65-41 (Supp. 1983).

[224] MISS. CODE ANN. § 21-41-1 (1972).

[225] *Id.* § 21-41-3 (1972).

[226] *Id.* § 21-41-9 (1972).

[227] *Id.* §§ 21-41-5, -7, -13 (1972).

[228] *Id.* § 21-41-15 (1972). After the improvement has been completed, the municipality must prepare an "assessment roll," which shows the names of each owner affected by the special assessment and a description of all the parcels that have been benefited by

(i) Application

The Municipal Special Assessments Lien attaches to the subsurface estate in benefited property prior to severance only. Once the mineral estate is severed, a mineral documentary tax is paid in lieu of all prospective taxes levied by "any county, municipality, levee district, road district, school district, drainage district or other taxing district within the state . . . ."[229] If the assessment occurs prior to severance, a release must be obtained by payment of the full amount of the outstanding assessment.

H. Special District Tax Liens

The Mississippi Code provides for the imposition of certain taxes to finance activities that benefit various localities within the state: drainage district taxes,[230] flood control district taxes,[231] separate road district taxes,[232] and municipal separate school

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the improvement. The "assessment roll" is recorded in the "Assessment Book For Local Improvements" maintained by the city clerk as notice of all special assessment liens. MISS. CODE ANN. § 21-41-13 (1972). Special assessment taxes are collected in the same manner as any other municipal ad valorem taxes and are subject to the statutes regulating the enforcement and collection of such taxes. *Id.* § 21-41-25 (1972).

[229] *Id.* § 27-31-73 (1972).

[230] Drainage districts with local commissioners may be formed when twenty-five percent or more of the owners of real property within a proposed drainage district successfully petition the chancery court to establish a drainage district. MISS. CODE ANN. § 51-29-5 (Supp. 1983). Drainage districts with county commissioners also may be formed for the purpose of reclaiming wetlands, swamp or overflowed lands. *Id.* § 51-31-5 (1972). Upon establishment of a local commissioner drainage district, an assessment roll is prepared assessing a proportionate share of the costs of the drainage district to each landowner whose property lies within the district. *Id.* § 51-29-29 (Supp. 1983). Additional assessments may be made to cover the costs of maintaining the system if necessary. *Id.* § 51-29-79. The bonds and other forms of indebtedness issued by the drainage district commissioners constitute a lien upon the land in the drainage district in an amount not to exceed the benefits received by the land. *Id.* § 51-29-45 (1972). The assessments are treated in the same manner as state or county ad valorem taxes and are due and payable at the same time. *Id.* §§ 51-29-51, -81 (1972).

[231] Flood control districts with local commissioners may be formed for the purpose of cooperating with the federal government in construction of flood control improvements. *See id.* §§ 51-35-105, -107, -127 (1972). The board of commissioners of the flood control districts and the county board of supervisors are authorized to levy ad valorem taxes upon the lands in the district for repair of flood control works and improvements. These taxes are collected at the same time and in the same manner as state and county taxes, and carry the same penalties for nonpayment. *See id.* §§ 51-35-179, -183 (1972).

[232] Separate road districts may be created and organized by the county board of

district taxes.[233] These taxes are assessed either as ad valorem taxes or according to the benefit afforded specific property by the activity financed.[234] The Code provides complementary liens to secure the payment of these taxes.

(i) Application

The liens that attach to the property serving as the basis of the special district tax assessments,[235] attach to the subsurface estate of the assessed property prior to severance only. If the mineral estate was severed prior to the assessment, the mineral documentary tax paid with the recording of the instrument of conveyance, modification or reservation of the mineral estate stands in lieu of all special district taxes thereafter sought to be collected.[236]

Any owner of lands may secure the release of his land from the lien by paying the full amount of the outstanding assessment against his property. A landowner may also secure the release of his lands from a drainage district lien by paying to the drainage

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supervisors or by a successful petition to the chancery court of twenty percent or more of the landowners in the proposed district. MISS. CODE ANN. § 65-19-1 (1972). Once a special district has been created, the board of supervisors is authorized to levy on and collect from the landowners taxes sufficient to cover the costs of construction and maintenance of roads in the district. *See id.* §§ 65-19-33, -87 (1972). The taxes so levied constitute a tax lien on the lands benefitted and are subject to the same provisions concerning collection and enforcement as are state and county ad valorem taxes. *See id.* §§ 65-19-85, -87 (1972).

[233] Municipal separate school districts may be established by a municipal ordinance approved by the state education finance commission. Lands outside of the municipality may be included within the municipal separate school district by order of the county board of education with consent from the board of trustees of the separate district and approval from the state educational finance commission. *Id.* § 37-7-605 (1972). The municipality is authorized to levy taxes upon all taxable property within the district to pay for the costs of operating the special school district. *Id.* § 37-7-615 (1972). The taxes for the municipal separate school district are collected and constitute liens similar to those for municipal ad valorem taxes. *See id.* §§ 37-7-735 (1972).

Since the municipal separate school district may include lands situated outside of the municipality, anyone who examines title to lands outside of any municipality, but possibly within a municipal separate school district, should check to determine that the school district taxes have been paid in full, unless the taxes arose after payment of a mineral documentary tax. *See supra* note 229 and accompanying text.

[234] *See supra* notes 228, 231.

[235] *See supra* notes 230, 231, 232, 233.

[236] *See supra* note 229 and accompanying text.

commissioners an amount agreed upon by the drainage commissioners and the owners of all outstanding bonds of the drainage district. Ordinarily, however, this will not have the effect of releasing the land from its liability for any annual maintenance taxes.

X. Lis Pendens and Judgment Liens

A. Lis Pendens

Under the common law doctrine of lis pendens, any person, whether a bona fide purchaser or not, who acquires an interest in real property from a party involved in pending litigation concerning the right, title or interest of the seller in such property, takes subject to and is bound by the terms of a decree subsequently entered in the litigation.[237] The Mississippi Code abrogates this common law doctrine, providing instead that a purchaser or encumbrancer takes subject to the decree only if the purchaser or encumbrancer had actual knowledge of the asserted claim, or a written notice of the existence of the claim had been previously recorded in the "Lis Pendens Record" maintained by the local chancery clerk.[238] Although the filing of a lis pendens notice does not create a lien upon the property,[239] it does constitute constructive notice to all persons that rights in the property are being asserted and those who bargain for rights in it do so at

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[237] *See, e.g.*, Nelson v. Ratliff, 72 Miss. 656, 667-68, 18 So. 487, 488-89 (1895). *See generally* V. Griffith, *supra* note 57, § 527, at 541 (discussing common law doctrine as applied in Mississippi before statutory abrogation).

[238] Miss. Code Ann. § 11-47-9 (1972). *See also id.* § 11-47-1 (1972) ("Lis Pendens Record" to be maintained by chancery clerk); *id.* § 11-47-7 (1972) (lis pendens notices must be indexed under the names of all the parties to the suit to be effective against subsequent purchasers).

Even if the lis pendens notice is properly recorded, it will not constitute constructive notice to subsequent purchasers if it contains a misdescription of the *res* over which the dispute arose. This is true even if the pleadings filed with the court contain an accurate description. McDaniel v. Latham, 143 Miss. 672, 675, 109 So. 671, 672 (1926).

[239] Ryals v. Douglas, 205 Miss. 695, 716-17, 39 So. 2d 311, 314 (1949). A lis pendens notice must also be filed in the local Lis Pendens Record when property is levied upon by virtue of *any* process, unless it is an execution upon a judgment that is already enrolled in the local judgment roll. Miss. Code Ann. § 11-47-5 (1972). Otherwise, subsequent purchasers or encumbrancers for value without actual knowledge of the levy are not bound by it. *See id.* § 11-47-9 (1972).

their peril.[240] When the suit or levy has been concluded, the court in which the matter was pending is required to direct the clerk to make appropriate entries in the lis pendens record to give "notice of the result of the proceedings and of the devolution of the real estate."[241]

B. Judgment Liens

By statute, the clerk of the circuit court in each judicial district is required to maintain a "Judgment Roll" in which the clerk enrolls all final judgments that may be satisfied by execution against the defendant's property.[242] Once enrolled, a final judgment becomes a lien against all the real and personal property of the defendant located within that judicial district, whether that property is then owned or thereafter acquired.[243] If the judgment is enrolled within twenty days of the adjournment of the term in which it is rendered, attachment and perfection of the judgment lien will relate back to the date the judgment was rendered, except against purchasers or encumbrancers for value without actual knowledge of the judgment. The lien attaches and takes priority against such purchasers or encumbrancers only from the date of enrollment of the judgment and not the

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[240] *See* V. GRIFFITH, *supra* note 57, § 527, at 542.

[241] MISS. CODE ANN. § 11-47-11 (1972).

[242] All final judgments rendered during a particular term of court are enrolled alphabetically according to the name of the defendant against whom the judgment was entered. *Id.* § 11-7-189 (1972).

A chancery court decree for money enforceable by execution against the defendant must be enrolled in the judgment roll maintained by the circuit court in order to be a *perfected* judgment lien. *See id.* § 7-5-159 (1972).

[243] A judgment may be enrolled in any county or judicial district within the state, and the lien created thereby attaches to all property of the defendant in the county or judicial district within which it is enrolled. *See* MISS. CODE ANN. §§ 11-7-191, -195, -197 (1972).

Once the judgment lien attaches, the judgment creditor can take no greater interest in the property of the judgment debtor than the judgment debtor has or thereafter acquires. *See* Motors Sec. Co. v. B. M. Stevens Co., 225 Miss. 361, 365, 83 So. 2d 177, 179 (1955) (enrolled judgment lien attaches to all of judgment debtor's after-acquired property); Foute v. Fairman, 48 Miss. 536, 550 (1873) (judgment creditor assumes no greater interest than that of the judgment debtor at the moment the judgment lien attaches). The lien created by enrollment of a judgment is general rather than specific, and covers all the property of the judgment debtor in the county. *See Foute*, 48 Miss. at 550.

date of its rendition.[244] In order to execute the lien, the judgment creditor must levy on property owned by the judgment debtor and cause it to be sold.[245]

A judgment lien expires seven years from the date the judgment is rendered, unless within the seven years the judgment creditor files a second suit against the judgment debtor for the amount remaining unpaid on the initial judgment. If the judgment lien is allowed to expire, the judgment creditor can no longer execute upon the property of the judgment debtor to satisfy the judgment, and the general lien created by the judgment's enrollment is no longer enforceable against subsequent bona fide purchasers from the judgment debtor.[246]

C. Application

To determine whether an owner in a chain of title is subject to a judgment lien, a title examiner should consult the Judgment Roll in the office of the circuit clerk and the book of final records in chancery located in the chancery clerk's office. If a judgment has been enrolled against a mineral owner, it will be

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[244] *See* Herrington v. Heidelberg, 244 Miss. 364, 369, 141 So. 2d 717, 720 (1962); *see also* Johnson v. Cole Mfg. Co., 144 Miss. 482, 489, 110 So. 428, 429 (1926) (if judgment not enrolled within the 20 day statutory period the judgment lien does not attach until it is recorded).

[245] Willis Hardware Co. v. Clark, 216 Miss. 84, 93, 61 So. 2d 441, 442 (1952). Upon satisfaction of the judgment, the circuit clerk is authorized to mark the judgment satisfied in the judgment roll. MISS. CODE ANN. § 11-7-189 (1972).

[246] *See* MISS. CODE ANN. § 15-1-43 (1972) (seven-year statute of limitations on judgment liens). In Street v. Smith, 85 Miss. 359, 363, 37 So. 837, 838 (1905), the Mississippi Supreme Court emphatically stated that the predecessor statute to MISS. CODE ANN. 89-5-19 (1972) "has no application to judgment liens." The court further said:

> A judgment lien is established only by a solemn and final adjudication of a competent court . . . so it can only be renewed or extended by a similar process. The lien of a judgment can be extended by the filing of another suit upon the judgment before the expiration of seven years from the date of the rendition thereof, and in no other manner.

Id. at 363-64, 37 So. at 838, *cited with approval in* Anderson-Tully Co. v. Brown, 383 So. 2d 1389, 1390 (Miss. 1980). MISS. CODE ANN. § 89-5-19 (1972) provides that judgments to enforce *consensual* liens may be renewed beyond the statutory period of seven years by agreement between the lienee and lienor. The renewal keeps the lienee's priority against intervening encumbrancers intact so long as notation of the consensual renewal is entered in the record book where the lien is recorded within six months of the seventh anniversary of the rendition of the judgment.

necessary to satisfy the judgment, or obtain either a release of the mineral estate from the lien or a subordination of the lien prior to leasing the mineral estate. An unenrolled judgment lien has no effect on the validity of an oil, gas, and mineral lease unless the lessee has actual knowledge of it before it was enrolled.[247] If a modification, renewal, or extension, however, is sought subsequent to enrollment, the lien will need to be satisfied or subordinated, or the lands released from the lien.

XI. Chancery Decrees

Dissolution of marriage by divorce does not, of itself, affect title of the respective parties to real estate owned by them.[248] The chancery court cannot of its own volition in a divorce proceeding divest either spouse of title to their respective property by judicial decree.[249] The chancery court can, however, order one spouse to surrender to the other possession and exclusive use of certain real property in which both own an undivided interest.[250] The grant of exclusive usage to one party of jointly or commonly owned property is made pursuant to the court's plenary authority to award alimony or child support when the circumstances warrant.[251] Although such a grant is not in any manner a divestiture of legal title from the non-using spouse, it does create rights that are superimposed upon the legal title of that spouse.[252]

If an award of alimony is granted, the court may decree a lien upon all or a portion of the real property of the alimony obligor to serve as security for the payment of the alimony obligation.[253] This lien does not arise automatically with an award of alimony, but must be specifically set forth in the decree of the

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[247] *See supra* note 244 and accompanying text.

[248] Miller v. Miller, 298 So. 2d 704, 706 (Miss. 1974).

[249] *E.g.*, Bridges v. Bridges, 330 So. 2d 260, 263-64 (Miss. 1976).

[250] Buckalew v. Stewart, 229 So. 2d 559, 562 (Miss. 1969).

[251] *See* Rhodes v. Rhodes, 336 So. 2d 1315, 1316 (Miss. 1976) (an award of the use and occupancy of the marital dwelling to one spouse is "in the nature of continuing alimony payable by the month"); Miss. Const. VI, § 159 (chancery court has "full" jurisdiction in divorce and alimony matters); Miss. Code Ann. § 93-5-23 (Supp. 1983) (decision whether to order payment of alimony is within the sound discretion of "the court").

[252] N. Hand, Jr., Mississippi Divorce, Alimony and Child Custody § 12-1 (1981).

[253] *E.g.*, Pierce v. Pierce, 267 So. 2d 300, 302 (Miss. 1972) (chancellor permitted to place lien upon property of husband to insure payment).

court. If such a lien is not initially provided for in a divorce decree, it may be decreed by the court at a later date if the alimony obligor is either unwilling or unable to comply with the terms of the decree.[254]

The lien remains affixed to the designated property of the alimony obligor until the duty either automatically ceases pursuant to the divorce decree (for example, when the recipient remarries) or the court orders the removal of the lien. The lien is an encumbrance that runs with the land, and in the event of default in the payment of alimony, the property upon which the lien runs may be levied upon and sold.[255]

While this lien is a creature of court decree, a spouse seeking a divorce coupled with an award of alimony to be secured by a lien against real property owned by the other spouse may file a notice in the lis pendens records in the county where the property of the defendant spouse is situated. If the remedy sought is granted by the court, the lien will be superior to any other interest in the property arising subsequent to the date of the filing of the lis pendens notice.[256]

A. Application

The title examination should include an examination of the chancery court docket to ascertain the likelihood of the existence of a lien upon the current mineral owner's interest as security for the payment of an alimony obligation. If the search of the docket reveals that the mineral owner is or has been involved in a divorce proceeding, the docket should be further searched in order to determine whether a divorce decree has been filed, and if so, whether there have been subsequent proceedings in the case. If a decree of divorce has been entered, its

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[254] *See* Morgan v. Morgan, 397 So. 2d 894, 897 (Miss. 1981) (reasonable for lien to be imposed following failure to comply with order).

[255] *See* Felder v. Felder's Estate, 195 Miss. 326, 337-38, 13 So. 2d 823, 827 (1943). In *Felder,* the husband, who had remarried, sought to avoid the lien by claiming that the land against which the lien was to be enforced was his current homestead with his second wife. While recognizing that a homestead is exempt from levy or sale under ordinary execution or attachment for collection of a debt, the Mississippi Supreme Court refused to allow the former husband to avoid the lien. *Id.* at 338-39, 13 So. 2d at 827-28.

[256] W.H. Gallaspy's Sons Co. v. Massey, 99 Miss. 208, 215-17, 54 So. 805, 807 (1911).

terms should be closely scrutinized. In the event no provision is made in the decree for an award of alimony, no lien can subsequently be imposed, because a party seeking alimony must assert his or her claim prior to entry of the divorce decree. If the decree imposes an obligation to pay alimony but affixes no lien, it would be prudent to check the chancery docket and court file for further proceedings to insure that a lien has not been imposed later. Ordinarily, imposition of a lien by judicial amendment of the decree will follow a default in alimony payments. The chancellor will decree a lien upon finding that the default was without just cause and without grounds for a modification of the payments, and that the default constituted contempt of court.

In addition, careful attention should be given to the lis pendens filings, because a party may file a notice in the lis pendens record that contempt proceedings for failure to pay alimony are pending against a party and that the imposition of a lien to secure both arrearages and future payments will be sought. In either case, if the court grants the lien, it will be effective from the date the notice was filed in the lis pendens record.

Finally, notice of the possible existence of a judicial lien securing payments of alimony may also be obtained from an examination of the judgment roll in the office of the circuit clerk. The Mississippi Code imposes upon the chancery clerk a duty to report all decrees of money to the circuit clerk within ten days of the end of the term of the chancery court so that the decree may be enrolled in the judgment roll.[257] Since an alimony decree fits within that description, it should be found in the judgment roll maintained by the circuit clerk.

If a lien to secure alimony has been imposed on and attached to the property of a mineral owner prior to the time a lease is executed, it will be necessary to undertake negotiations with the alimony obligee to secure an agreement either subordinating the lien to the lease or releasing the mineral estate from the reach of the lien. If the lien attached subsequent to the execution of the oil, gas, and mineral lease, the rights of the lessee thereunder will not be affected unless a subsequent renewal,

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[257] MISS. CODE ANN. § 9-3-159 (1972).

modification or extension is sought.

XII. Attachment

A. *Attachment in Chancery*

Attachment is the process of seizing property under judicial order to bring that property into the legal custody of the courts.[258] Attachment in chancery is simply that process brought about by a judicial order issued by the chancery courts.[259] Generally, attachment in chancery is available to anyone who has unsuccessfully demanded payment upon a legal or equitable claim against a "nonresident, absent or absconding debtor" owning property situated in Mississippi.[260] Once these jurisdictional requisites have been shown to exist, the request for attachment is properly before the chancellor. The chancellor may then issue a writ of attachment *ex parte* upon the complainant's showing that his affidavit on its face establishes his right to recover, that failure to obtain an attachment would prejudice his ability to recover his claim, and that the complainant is able to post adequate bond.[261] If the order of attachment is issued, the defendant, at his request, will be afforded an opportunity to specially appear and promptly seek its dissolution prior to the seizure of

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[258] *See generally* Blacks Law Dictionary (5th ed. 1979) (giving illustrative cases).

[259] *Compare* Miss. Code Ann. § 11-31-1 (1972) (granting chancery courts exclusive jurisdiction to issue writs of "attachment in chancery") *with id.* § 11-33-1 (1972) (granting jurisdiction to issue writs of "attachment at law" to supreme court judges, circuit court judges, chancellors, justice court judges, mayors, and clerks and deputy clerks of the chancery and circuit courts).

[260] *See* Miss. Code Ann. § 11-31-1 (1972); Aetna Ins. Co. v. Robertson, 126 Miss. 387, 406, 88 So. 883, 890 (1921) (attachment proper in case of unsatisfied demand for payment of contractual indebtedness and statutory penalties for violation of antitrust laws); Wallace v. Lucas, 42 So. 607, 607 (Miss. 1907) (officially unreported opinion) (attachment proper in case of unsatisfied demand for unliquidated tort damages). All foreign corporations have been held to be nonresidents within the statute, including those foreign corporations domiciled and qualified to do business within the state and actually present here. *E.g.*, Clark v. Louisville & Nashville R.R., 360 So. 2d 925, 926 (Miss. 1978). An individual is considered a nonresident if he cannot be served with ordinary process in the same manner as a resident of the state of Mississippi. Brown v. Crane, 69 Miss. 678, 682, 13 So. 855, 856 (1892).

[261] Miss. Code Ann. § 11-31-2(2) (Supp. 1983).

the property.[262] If the debtor does not avail himself of the opportunity for a post-seizure hearing, or is unsuccessful at the hearing, he nevertheless may regain possession of the property by posting security adequate to protect the complainant's interest.[263]

Jurisdiction to issue the order of attachment extends to the disposition of the claim on its merits. If, however, the court enters a decree in the case without the appearance of the debtor,[264]

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[262] *Id.* § 11-31-2(3) (Supp. 1983). Section 11-31-2 was added to the Mississippi Code in response to two judicial decisions declaring the Mississippi chancery attachment statutes violative of the fourteenth amendment's due process clause for, among other things, failure to "require even a rudimentary *ex parte* hearing." *See* Mississippi Chem. Corp. v. Chemical Constr. Corp., 444 F. Supp. 925, 938 (S.D. Miss. 1977). *See also* M P I, Inc. v. McCullough, 463 F. Supp. 887, 892, 899-901 (N.D. Miss. 1978) (citing *Mississippi Chem. Corp.*) (declaring chancery attachment of realty unconstitutional on ground that it clouded title, which constitutes a significant deprivation of property).

Essentially tracking the judicial admonition in *Mississippi Chem. Corp.*, section 11-31-2 adds to the chancery attachment scheme the requirements that (1) the complainant allege by affidavit *specific* facts sufficient to support a reasonable conclusion that his recovery is endangered absent attachment, (2) the affidavit be reviewed by a chancellor, (3) the complainant post an adequate bond to protect the attachment defendant from loss, and (4) upon request the attachment defendant be given an immediate post-seizure hearing.

Conspicuously absent is any legislative response to the expression of concern by the court in *Mississippi Chem. Corp.* that the chancery attachment scheme may yet be unconstitutional because "all debts owing to the principal defendant are subject to attachment regardless of where the debts arose, provided only that the attachment defendant be served within the State of Mississippi. . . ." 444 F. Supp. at 938. *See also* MISS. CODE ANN. § 11-31-3 (Supp. 1983) (re-enacted statutory authority for the attachment of debts merely by service within the state of attachment defendant). Therefore, the Mississippi chancery attachment scheme may still be unconstitutional in light of the United States Supreme Court's recognition that, although a defendant ought not to be able to avoid suit by removing his assets from the jurisdiction, the mere presence of property in the forum state is not determinative of jurisdiction. *See* Shaffer v. Heitner, 433 U.S. 186, 207-10 (1977); *see also* International Shoe Co. v. Washington, 326 U.S. 310 (1945) (jurisdiction must be based upon sufficient minimum contacts between the defendant and the forum state that subjecting defendant to suit there "does not offend 'traditional notions of fair play and substantial justice' ").

[263] *Compare* MISS. CODE ANN. § 11-31-2(3)(b) (Supp. 1983) (attachment defendant's bond required by statute to be the lesser of 125% of the value of the seized property or 125% of the amount of the claim) *with id.* § 11-31-2(2) (Supp. 1983) (attachment plaintiff's pre-seizure bond must merely be "an amount satisfactory to the chancellor").

[264] Service of process upon the non-resident, absent or absconding debtor is by publication of summons. *Id.* § 11-31-9 (Supp. 1983). *But cf.* Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306, 315 (1950) (failure to give notice by means "such as one desirous of actually informing the absentee might reasonably adopt" violates due

before the complainant can satisfy his judgment out of the proceeds from the sale of the property, he must give security in an amount sufficient to restore the estate of the debtor should the debtor appear and answer the bill of complaint within two years. If the complaintant fails to give security, the property must remain under the court's direction for the two-year period, and then may be disposed of only in accordance with an order of the court.[265] Of course, if the debtor should appear and prevail, the order of attachment will be dissolved.

(i) Application

An examination of the chancery dockets in the appropriate chancery clerk's office will reveal the existence of a suit for attachment in chancery. The chancery docket, court file, and Chancery Minute Book will reveal the status or result of such an action. If a mineral lease is outstanding at the time of the filing of an attachment in chancery, the proceedings will not affect the validity of the lease. If an attachment in chancery precedes the attempt to acquire an oil, gas, and mineral lease, or if it becomes necessary to obtain a ratification or other modification of an exisiting lease after an attachment in chancery has been filed, it will be necessary, by examination of the chancery court records mentioned above, to determine the status of the action. If the lands have been sold pursuant to a decree of the court, the lease, ratification or modification, must be obtained from the purchaser at the sale. If the matter is still pending, and the acquisition of the lease, ratification or mofidication cannot be deferred until the matter is fully adjudicated or otherwise resolved, all parties to the attachment proceedings should be required to join in the lease, the ratification or the modification.

B. Attachment at Law

The remedy of "attachment at law" represents the separate statutory framework with which a creditor must comply to obtain a writ of attachment from any Mississippi court other than

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process).

[265] Miss. Code Ann. § 11-31-11 (1972).

the chancery court.[266] Although fairly comprehensive, the attachment at law statutes were found constitutionally deficient in *Mississippi Chemical Corp. v. Chemical Construction Corp.*[267] Since that case was decided in 1977, the Mississippi Legislature has made only superficial changes to these statutes, so that their constitutionality remains seriously in doubt.[268]

(i) Application

In light of the recent United States Supreme Court decision in *Lugar v. Edmondson Oil Co.*,[269] it is highly unlikely that an informed attorney would attempt an attachment at law in Mississippi.[270] In *Lugar*, the Court said a debtor could recover damages under 42 U.S.C. § 1983 from a creditor who had attempted an attachment under the constitutionally defective Virginia attachment statutes.[271] In that case, the attachment statutes had

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[266] The Mississippi statutes governing "attachment at law" are located at MISS. CODE ANN. §§ 11-33-1 to -107 (1972 & Supp. 1983).

[267] 444 F. Supp. 925 (S.D. Miss. 1977). In *Mississippi Chemical Corp.*, the court found the Mississippi attachment at law statutes unconstitutional for, among other things, failure to provide for a prompt post-seizure hearing and failure to require the creditor to post bond (although a defendant could post a bond to recover property already seized). *Id.* at 940-42. After discussing these and other due process objections to enforcement of these statutes, the court concluded:

> Accordingly, this Court is of the opinion that while the attachment at law procedure provides many more safeguards for a principal defendant than the attachment in chancery procedures, the statutory scheme is still constitutionally deficient in many respects . . . .

Id. at 942.

[268] *See* MISS. CODE ANN. §§ 11-33-17, -19, -105 (Supp. 1983) (amendments made solely to reflect change in name of justice of the peace court to justice court).

[269] 457 U.S. 922 (1982).

[270] Although under the terms of the statute real property may be levied on by a writ of attachment at law; see MISS. CODE ANN. § 11-33-23 (1972); such an event should rarely, if ever, occur. A more likely use of these statutes would be to attach delay rentals or royalty payments.

[271] Lugar's property was seized under the Virginia prejudgment attachment statutes, which required only that the creditor allege in an ex parte petition that it had grounds to believe that attachment was necessary in order to prevent the debtor from disposing of his property. 457 U.S. at 924. *See* MISS. CODE ANN. § 11-33-9 (1972) (creditor obtains writ of attachment at law from court clerk by submitting petition containing conclusory allegation based on information and belief). Thirty-four days after Lugar's property was seized, he was able to get the attachment dissolved for the creditor's failure to prove specific facts reasonably supporting its contention that, without attachment, disposal of assets was imminent. 457 U.S. at 925. Lugar then filed suit under 42 U.S.C. § 1983 alleg-

not been previously challenged on due process grounds.[272] Therefore, it seems reasonable to conclude that an attorney is courting disaster if he seeks an attachment at law in Mississippi at any time prior to substantial amendment of the Mississippi attachment at law statutes. If for example, delay rentals or royalties are attached prior to such amendments, not only should an attorney have substantial grounds for having it dismissed, he may be able to advise the attachment debtor of the possibility of the existence of a *Lugar*-type claim. The availability of a *Lugar*-type claim may even provide leverage in obtaining subordination or release of other liens or encumbrances.

XIII. Liens And Encumbrances Arising During Administration of Decedents' Estates

Since chains of title may contain one or more testamentary dispositions, a title examiner should be acutely aware of the types of liens and encumbrances that may attach to the assets of a decedent during the administration of an estate.

A. Creditor's Claims

In Mississippi the just debts, funeral expenses, and other expenses relating to the closing of an estate first must be satisfied out of the personal property of the decedent. If the personal property is insufficient to satisfy all of the debts and expenses, the remaining debts and expenses are satisfied out of the decedent's real property.[273]

In cases in which no administration of the estate of the de-

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ing that Edmondson Oil Co. had acted jointly with the state "under color of state law" to deprive him of his property without due process of law. 457 U.S. at 925. The Supreme Court held that, because the debtor's property deprivation resulted from joint action by state officers and the private creditor pursuant to a procedurally defective attachment statute, the debtor had presented a valid claim under 42 U.S.C. § 1983. The case was remanded for trial on factual issues. The court reserved the question concerning the availability of a good faith defense. 457 U.S. at 941-42.

[272] In fact, Lugar himself disclaimed a challenge of the constitutionality of the Virginia statute during oral argument of the case before the Supreme Court. 457 U.S. at 940-41 n.22. Nevertheless, the majority felt that a challenge of the statute was essential to Lugar's claim and interpreted Lugar's argument accordingly. *Id.* at 940.

[273] Miss. Code Ann. § 91-7-91 (Supp. 1983).

cedent has been commenced within three years of the date of death, unsecured creditors of the decedent are required to file a notice of their claims on the lis pendens docket in the office of the chancery clerk of the county in which the real property is located, or their claims will not attach to the real property of the decedent.[274] The claim still must be sued upon within the applicable statutory period or it will be barred; filing the notice cannot preserve it against the estate.[275]

Upon being granted letters of administration or letters testamentary, an administrator or executor is required within ninety days to publish notice of the administration to all persons having liquidated claims against the estate. This notice must direct those persons to have their claims registered and probated within ninety days after date of the first publication of the notice.[276] All liquidated claims of creditors against the estate not registered and probated within this period of time are barred and are unenforceable against the estate.[277] Unliquidated claims are barred by the statute of limitations unless asserted within four years and ninety days of the granting of letters testamentary or of administration.[278] Apparently, unliquidated claims

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[274] MISS. CODE ANN. § 91-7-91 (Supp. 1983).

[275] To illustrate, assume that the decedent had been killed by a party acting with reasonable defensive measures against the decedent's attempted assault and battery. Under Mississippi law, the assaulted party would have one year and ninety days from the date of death within which to file suit against decedent's estate for compensatory damages. *See* MISS. CODE ANN. § 15-1-35 (Supp. 1983) (one-year statute of limitations for intentional torts including assault and battery); *id.* § 15-1-25 (Supp. 1983) (granting an extension of up to one year from date of death for all claims available against a decedent who dies within one year of when the claim would have become time barred); *id.* § 91-7-239 (Supp. 1983) (claims ex delicto may not be filed against the estate during the ninety days immediately following qualification of the administrator or executor). *See, e.g.*, Jennings v. Love, 24 Miss. (2 Cush.) 249, 255-56 (1852) (interpreting predecessor statutes—the ninety-day moratorium is added on to the applicable statutory period).

[276] MISS. CODE ANN. § 91-7-145 (Supp. 1983). The notice is required to be published for three consecutive weeks in a newspaper published in the county or, in some instances, merely posted at the courthouse door and at two or three other public places for three consecutive weeks. *Id. See also id.* § 19-7-145 (1972) (less stringent notice requirements for estates of not more than $500).

[277] *Id.* § 91-7-151 (Supp. 1983).

[278] *Compare* MISS. CODE ANN. § 15-1-25 (1972) (*all* claims against the estate must be asserted within four years of qualification of administrator or executor) *and id.* § 91-7-239 (Supp. 1983) (suits may not be filed against the estate during the ninety days immediately following qualification of the administrator) *with* Powell v. Buchannan, 245 Miss.

that would have been available for up to six years are nevertheless time-barred if not asserted within four years and ninety days of the granting of letters even if the statutory notice provisions were not complied with.[279]

Once the claim has been registered with the chancery clerk, or filed in the lis pendens records in the case of unadministered estates, it constitutes notice of the claim against the estate to all persons. Before it is payable by the executor or administrator, however, it must be duly probated.[280] In the probate of the claim, the executor or administrator, legatee, heir or any other creditor may contest the claim.[281] The executor or administrator is authorized to petition the chancery court for authority to sell real property of the decedent if the personalty is insufficient to pay all of the probated claims against the estate.[282] The creditors may file a petition if the executor or administrator fails to do so and their claim has not been satisfied.[283]

Secured creditors of the decedent who have liens or security interests in property of the decedent are not barred from enforcing their liens against the property to which the liens or security interests are attached, even if they have failed to register their claims against the decedent's estate within the above mentioned limitation periods. If, however, they have not so registered their claims, they may seek satisfaction of their claims only out of the property to which their liens have attached. If the secured property is insufficient to satisfy their claims and they have not registered their claims within the prescribed period, the secured

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4, 9-10, 147 So. 2d 110, 112 (1962) (interpreting predecessor statutes—unliquidated claims are governed by the four-year statute of limitations but cannot be brought against the estate within the moratorium period) *and* Jennings v. Love, 24 Miss. (2 Cush.) 249, 255-56 (1852) (moratorium is added to the applicable statutory period). *See generally* R. WEEMS, MISSISSIPPI WILLS AND ESTATES § 2-10, at 84 (1983) (background discussion).

[278] Sivley v. Summers, 57 Miss. 712, 729 (1880) (the four year limitation on all claims against the state runs without regard to publication of any notice); *see also* MISS. CODE ANN. § 15-1-49 (1972) (establishing a general six-year statute of limitations for claims for which no other statutory period is provided); *id.* § 15-1-25 (providing that no claim against the estate may be brought "except within four years after qualification of [the] executor or administrator").

[280] MISS. CODE ANN. § 91-7-155 (1972).

[281] *Id.* § 91-7-165 (1972).

[282] MISS. CODE ANN. § 91-7-191 (1972).

[283] *Id.* § 91-7-195 (1972).

creditors are barred from commencing any action against the decedent's estate for the deficiency.[284]

(i) Application

The title examiner should carefully examine the chancery dockets and will books to determine whether any owner in the chain of title died while owning an interest in the property that may be subject to a lien or encumbrance. The court file should be examined to determine whether any claims of creditors against the estate have been registered and probated. A determination should then be made whether the applicable statutes of limitations have run against any creditors who have not registered their claims. If the notice to creditors has been properly published, all liquidated claims of creditors not registered within ninety days from the date of the first publication are barred. Even when no estate administration has begun, liquidated claims against the decedent that have not been recorded in the lis pendens book within three years and six months after date of death may be satisfied only out of the personalty of the estate.[285]

If further claims against the particular property are barred, the title examiner need only be concerned with the registered claims that have been probated and not satisfied. As to unsatisfied probated claims against the estate, the title examiner may wish to have the claims subordinated or seek a release of the lands from the creditors. Another possible cure for these encumbrances would be a judicial determination that the personal property of the decedent's estate is sufficient to satisfy all of the claims of the creditors against the estate.[286]

B. Liens of Purchasers at Void Sales

A lien against a decedent's estate is also imposed by section 91-7-209 of the Mississippi Code. This lien arises in favor of a

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[284] *Id.* § 91-7-167 (1972).

[285] MISS. CODE ANN. § 91-7-91 (Supp. 1983).

[286] *See id.* § 91-7-91 (Supp. 1983). If the personalty is sufficient, the realty will not be sold to satisfy the claims unless the chancery court determines that it would be in the best interests of the distributees or legatees that the real property be sold in preference to the personal estate. *Id.* § 91-7-187 (1972).

purchaser of property of an estate sold by order of the chancery court, if the sale is eventually determined to be unlawful, in which event, title would not have passed to the purchaser. This provision gives the purchaser or his assigns a lien on the property to secure the repayment of the purchase price that he paid to the estate.[287]

[287] MISS. CODE ANN. § 91-7-209 (1972).

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COMMENTS

A CONSTITUTIONAL ANALYSIS OF THE MISSISSIPPI COMMERCIAL CODE'S CONFLICT OF LAWS PROVISION

I. Introduction

In virtually every tort and contract action in which the laws of more than one state may potentially govern litigation, Mississippi courts apply a balancing test to determine which state has the most significant interest in the lawsuit. In 1978, however, the Mississippi Legislature created an exception to this rule, proclaiming that in every action filed in Mississippi, this state's law on disclaimers of the implied warranties of merchantability and fitness for a particular purpose will apply, regardless whether another state may have an overriding interest in the litigation.[1] This legislative action is a violation of the full faith and credit and due process clauses of the United States Constitution. Additionally, there is no reasonable justification for applying a different choice of law analysis to actions in which a contract containing a disclaimer is involved. The Mississippi policy not only has enormous potential for undermining the sovereignty of sister states, but also is patently unfair because the state's open door policy, allowing

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[1] Act of Apr. 11, 1977, ch. 452, § 1, 1977 Miss. Laws 761. The amendment became effective on April 1, 1978. *Id.* The current conflicts provision provides:

> (1) Except as provided hereafter in this section, when a transaction bears a reasonable relation to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties. Failing such agreement, this code applies to transactions bearing an appropriate relation to this state. *Provided, however, the law of the State of Mississippi shall always govern the rights and duties of the parties in regard to disclaimers of implied warranties of merchantability or fitness, limitations of remedies for breaches of implied warranties of merchantability or fitness, or the necessity for privity of contract to maintain a civil action for breach of implied warranties of merchantability or fitness notwithstanding any agreement by the parties that the laws of some other state or nation shall govern the right and duties of the parties.*

Miss. Code Ann. § 75-1-105(1) (Repl. 1981) (emphasis added).

corporations doing business in the state to be sued in Mississippi on any cause of action, guarantees that Mississippi courts will nullify disclaimers valid in the state in which they were negotiated.

II. Background of Mississippi Conflict of Laws Rules

A. Contractual Relations

Mississippi courts have utilized the significant relationship test[2] in contract litigation since 1968, when it was adopted in *Craig v. Columbus Compress & Warehouse Co.*[3] In that case, the holder of warehouse receipts purchased in Tennessee and subsequently stolen in Mississippi filed a claim in Mississippi against a Delaware corporation for the market value of the cotton represented by the receipts.[4] Under Mississippi law, title to the receipts would not have passed through theft, while under Tennessee law, title would have vested in the purchaser of the stolen receipts.[5] The court adopted the center of gravity doctrine for actions on contracts, holding that the applicable law is that of the state having *either* the most significant relationship to the parties or events, *or* the "greatest concern with the specific issues."[6] Clearly, establishment of this dichotomy set the stage for allowing the courts to consider the strength of interest of each state in having its particular policy applied and to determine which state has the better rule of substantive law. This discretion, however, was limited by the requirement that the state whose rule was ultimately utilized have some relationship with either the parties or the events beyond the fact that the suit was filed within the state.[7]

The significant relationship test was more fully explained later that year in *Mitchell v. Craft*,[8] a wrongful death action.[9] The claim

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[2] *See infra* notes 6-12 and accompanying text.

[3] 210 So. 2d 645 (Miss. 1968).

[4] *Id.* at 646.

[5] *Id.* at 648.

[6] *Id.* at 649. In allowing application of the law of the state with the "greatest concern with specific issues," the court stated that the concern must be a result of the state's relationship either with the parties or with the occurrence. *Id.*

[7] *Id.*

[8] 211 So. 2d 509 (Miss. 1968).

[9] *Id.* at 510. In *Mitchell v. Craft*, the Mississippi Supreme Court adopted the significant relationship test for torts, abandoning the *lex loci delicti* rule, which required application of the substantive law of the state in which the injury occurred. *Id.* at 512-16. The *lex loci delicti* rule has been the subject of substantial scholarly criticism. *See, e.g.*, Cavers, *A Critique of the Choice-of-Law Problem*, 47 Harv. L. Rev. 173, 187-92 (1933)

arose when two automobiles collided in Louisiana, killing both drivers. Both decedents were Mississippi residents, were travelling to their homes here, and were having their estates administered within the state, leading the supreme court to conclude Mississippi had the most significant relationship to the litigation.[10] The court weighed four factors in making this determination: (1) the number of contacts the decedents had with each state; (2) predictability of result; (3) advancement of the forum government's interest; and (4) which state had the better substantive rule of law.[11] In opting to apply Mississippi's law instead of

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(*lex loci delecti* rule should be abandoned in favor of test that balances policies and interests of states); Cheatham & Reese, *Choice of the Applicable Law*, 52 COLUM. L. REV. 959 (1952) (listing nine factors that should be considered by courts and calling for abandonment of *lex loci delicti* rule). Consequently, most jurisdictions have abandoned it in favor of the center of gravity doctrine. *See, e.g.*, Wessling v. Paris, 417 S.W.2d 259, 260-61 (Ky. 1967) (recognizing the center of gravity test was "eminently sound"); Wilcox v. Wilcox, 27 Wis. 2d 617, 133 N.W.2d 408, 416-17 (1965) (significant relationship test properly controlling). *But see* Bodnar v. Piper Aircraft Corp., 392 So. 2d 1161, 1163-64 (Ala. 1981) (court recognizing *lex loci delicti* rule subject to much scholarly criticism, but holding that the rule still applied to tort actions in Alabama). *See generally*, Comment, *Abandonment of Lex Loci Delicti in Texas: The Adoption of the Most Significant Relationship Test*, 33 SW. L.J. 1221, 1221 n.4 (1980) (listing decisions in which most jurisdicitons abandoned *lex loci delicti* rule in favor of center of gravity test).

[10] *Mitchell v. Craft*, 211 So. 2d at 510.

[11] *Id.* at 513-14. The supreme court adopted the test outlined in RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 145 (Proposed Official Draft, Adopted May 24, 1968) (current version 1971):

> (1) the rights and liabilities of the parties with respect to an issue in tort are determined by the local law of the state which, as to that issue, has the most significant relationship to the occurrence and the parties under the principles stated in § 6.
>
> (2) Contacts to be taken into account in applying the principles of § 6 to determine the law applicable to an issue include:
>
> (a) the place where the injury occurred,
>
> (b) the place where the conduct causing the injury occurred,
>
> (c) the domicil, residence, nationality, place of incorporation and place of business of the parties, and
>
> (d) the place where the relationship, if any, between the parties is centered.
>
> These contacts are to be evaluated according to their relative importance with respect to the particular issue.

211 So. 2d at 515. *See also* RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 6, 188 (1971) (other factors to be considered in determining which state has most significant interest in litigation). The court also considered the five choice-influencing factors propounded in Leflar, *Choice-Influencing Considerations in Conflicts Law*, 41 N.Y.U. L. REV. 267, 282 (1966):

> (1) predictability of results; (2) maintenance of interstate and international order; (3) simplification of the judicial task; (4) advancement of the forum's

that of Louisiana, the court pointed out that the sole advantage of invariably applying the law of the state where the injury occurred was its "certainty and predictability,"[12] while using the substantive law of the state that had the most significant relationship to the dispute allowed the court to consider the forum state's governmental interests[13] as well as the better substantive rule of law.[14]

Since the *Mitchell v. Craft* and *Craig* decisions, Mississippi courts and federal courts applying Mississippi law have uniformly employed the significant relationship test to choice of law questions in both tort and contract actions,[15] examining the parties' relationship to the respective states,[16] as well as the substance of each state's law.[17] Undoubtedly, the Mississippi Supreme Court considers the content of the law to be of prime importance as it has occasionally required application of its own law to cases with only slight contacts with the state.

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governmental interest; and (5) application of the better rule of law.
211 So. 2d at 513-14.

[12] 211 So. 2d at 513. The court recognized that predictability of result is irrelevant in tort cases because people presumably do not decide to act negligently with an eye toward future liability, but is an important consideration in fashioning choice of law rules for consensual transactions. *Id.* at 514.

[13] *Id.* at 514. The court observed that Mississippi had a significant interest in having its law control the rights and liabilities of its residents while Louisiana had no interest in asserting its law over nonresidents. *Id.*

[14] *Id.* Significantly, Louisiana law would have allowed contributory negligence to bar the claim for damages resulting from the defendant's careless driving while Mississippi law would have applied the doctrine of comparative negligence. The supreme court concluded that comparative negligence was the better rule of law because it was "fairer and more economically equitable." Consequently, Mississippi law was chosen to resolve the dispute. *Id.*

[15] *See, e.g.*, J. Russell Flowers, Inc. v. Itel Corp., 495 F. Supp. 88, 91 (N.D. Miss. 1980) (Mississippi applies significant relationship test to determine which state's law applies to contract disputes); Vick v. Cochran, 316 So. 2d 242, 245 (Miss. 1975) (recognizing that state expressly rejected *lex loci delicti* in favor of center of gravity test); Turner v. Pickens, 235 So. 2d 272, 274 (Miss. 1970) (observing Mississippi modified pre-existing law that place of injury determined the substantive law of the case and required use of center of gravity test in all tort actions).

[16] *See, e.g.*, Maryland Casualty Co. v. Integrity Ins. Co., 693 F.2d 506, 508 (5th Cir. 1982) (Mississippi uses the center of gravity or significant relationships test so court must consider each state's connection with the occurrence); Galloway v. Korzekwa, 346 F. Supp. 1086, 1091 (N.D. Miss. 1972) (although accident occurred in Alabama, the center of gravity doctrine mandated application of Mississippi law because of quality of contacts to state and dominant interest of forum).

[17] *See, e.g.*, Wright v. Standard Oil Co., 470 F.2d 1280, 1284-85 (5th Cir. 1973) (when plaintiffs resided in Indiana, defendant resided in Mississippi, accident occurred in Mississippi, and Indiana substantive law might have violated equal protection clause of Constitution, under center of gravity doctrine, Mississippi law applied).

B. *Article 2 of the Commercial Code*

The center of gravity doctrine also applies to the majority of Article 2 of the Mississippi Commercial Code. When the state adopted the Commercial Code in 1966, the territorial application provision enacted by the Legislature provided that Mississippi law would apply only if the transaction bore an "appropriate relation" to the state.[18] The provision was interpreted in *Dunavant Enterprises, Inc. v. Ford*[19] to mean that the center of gravity test also applies to actions arising under Article 2. In this breach of contract action, the Mississippi Supreme Court approved the application of the significant relationship test in a case involving a claim governed by the sales provision of the Commercial Code.[20] The court observed that there was no true difference between the laws of Mississippi and Tennessee on the issues involved in the case,[21] indicating that the court regarded the substantive content of the law as an important consideration in deciding which state's law to use.

The view that the conflicts provision of the Commercial Code required application of the significant relationship test was also espoused by a federal district court interpreting Mississippi law in *Bunge Corp. v. Biglane*,[22] in which the court traced the history of the state's choice

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[18] MISS. CODE ANN. § 75-1-105(1) (1972). The provision also allowed the parties to contractually designate which state's law would govern any future disputes, so long as that state had a "reasonable relation" to the transaction. *Id. See generally* Adams, *The 1972 Official Text of the Uniform Commercial Code: An Analysis of Conflict of Laws Provisions*, 45 MISS. L.J. 281, 284-86 (1974) (ability of parties to agree on law for future litigation unclear because term "reasonable relation" not defined).

[19] 294 So. 2d 788 (Miss. 1974).

[20] *Id.* at 791. *See also* J. Russell Flowers, Inc. v. Itel Corp., 495 F. Supp. 88, 91 (N.D. Miss. 1980) (Mississippi applies significant relationship test to determine which state's law applies to contract disputes); Spragins v. Louise Plantations, Inc., 391 So. 2d 97, 99-100 (Miss. 1980) (in contract actions, state courts, applying significant relationship test, must determine which state has the most significant contacts, or the greatest concern with specific issues of liability); Craig v. Columbus Compress & Warehouse Co., 210 So. 2d 645, 649 (Miss. 1968) (choice of law in breach of contract action determined by center of gravity test). The intent of the drafters of the Code as expressed in the Official Comment to § 1-105(1) certainly does not preclude the use of the center of gravity test. *See* UNIFORM COMMERCIAL CODE OFFICIAL TEXT § 1-105(1) (1972) (Comment 3) (when two or more states have significant contacts with transaction, judicial discretion should be used to determine applicable law).

[21] 294 So. 2d at 791.

[22] 418 F. Supp. 1159 (S.D. Miss. 1976). The corporate plaintiff, doing business in Mississippi, was seeking damages for a Mississippi resident's failure to deliver grain grown and stored in Louisiana, pursuant to an oral contract made in Louisiana by an unauthorized agent of the defendant. *Id.* at 1161-62.

of law rules[23] and concluded that the state courts, following *Dunavant Enterprises*, would utilize the center of gravity doctrine under Mississippi Code Annotated section 75-1-105(1).[24] The factors the court considered included the places of contract, negotiation, and performance; the location of the subject matter of the contract; and the domiciles and residences of the parties.[25] The court did not, however, refer to the relevance of the "better rule of law."[26]

The law stood at this point until 1978, when the Mississippi Legislature amended the territorial application provision to require application of Mississippi substantive law on disclaimers of liability for the implied warranties of merchantability and fitness for a particular purpose, limitation of remedies for the two implied warranties, and privity. This provision applies in every case filed within the state's borders, regardless of the state's relationship to the parties or transaction.[27] The amendment additionally provides that even if the parties had agreed that another state's law would govern their rights and liabilities in future disputes, Mississippi law will apply to disclaimers of the implied warranties of merchantability and fitness for a particular purpose, notwithstanding the contractual agreement.[28]

The Mississippi Legislature's creation of an arbitrary territorial conflicts provision for consensual transactions disregards commonly accepted conflicts principles. As the Mississippi Supreme Court stated in *Mitchell v. Craft*, the primary goal in shaping conflicts rules for contractual relations should be to provide the parties with a basis for reasonably predicting future liability.[29] Clearly, if the parties agree upon another state's law, they have not contemplated the application of Mississippi law to resolve any dispute. This provision ensures not predictability, but rather that neither party will be able to predict with any certainty the liability that might be assumed by acting in a certain way.

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[23] *Id.* at 1162-64.

[24] *Id.* at 1164. The court pointed out that *Craig v. Columbus Compress & Warehouse* concerned the rights of parties prior to the adoption of the commercial code. 418 F. Supp. at 1164. Nevertheless, the court found that *Dunavant Enterprises*, which adopted the *Craig* center of gravity test, was controlling, and concluded that Louisiana had the most significant contacts. 418 F. Supp. at 1164-65.

[25] 418 F. Supp. at 1164.

[26] The "better rule of law" standard is one of the choice-influencing factors listed in Mitchell v. Craft, 211 So. 2d 509, 513-14 (Miss. 1968). *See supra* note 11 and accompanying text.

[27] MISS. CODE ANN. § 75-1-105(1) (Repl. 1981). *See supra* note 1.

[28] *Id.*

[29] 211 So. 2d at 513. *See supra* note 12.

This use of the territorial application provision was not contemplated by the framers of the Uniform Comercial Code, as they specifically stated that the mere filing of an action in a state does not equal an "appropriate relationship" to that state to justify application of its substantive law.[30] The drafters also observed what should be obvious—that the forum's substantive law should not be used to govern the contractual rights and liabilities of parties who clearly negotiated terms on the basis of some other jurisdiction's law.[31] Yet, by enacting section 75-1-105(1) the Mississippi Legislature has established in law the opposite of these sound propositions.

III. Potential of Section 75-1-105(1) To Undermine Public Policy of Sister States

The significance of this provision becomes readily apparent when one considers that Mississippi is one of only six states that limit the ability of sellers of goods to disclaim the two implied warranties and is the only state that prohibits disclaimers for non-consumer goods.[32] Although five states have recently amended their statutes to prohibit sellers from disclaiming the implied warranties with respect to consumer goods, Mississippi is the only state that prohibits disclaimers in all circumstances.[33] Mississippi is also the only state that mandates the use of its laws on disclaimers in all actions brought within the state.[34]

Other states have required that their policies be followed if the forum has even slight contacts with the parties, transaction, or occurrence, justifying the mandate by saying that the state's governmental interest was paramount.[35] This, nevertheless, differs significantly from

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[30] U.C.C. Official Text § 1-105 (1972) (comment 2).

[31] *Id.*

[32] *See* Miss. Code Ann. § 11-7-18 (Supp. 1982) (prohibiting all disclaimers of liability for remedies for implied warranties of merchantability and fitness for a particular purpose).

[33] *See* Me. Rev. Stat. Ann. tit. 11, § 2-316 (Supp. 1982); Md. Com. Law Code Ann. § 2-316.1 (Supp. 1983); Mass. Gen. Laws Ann. ch. 106, § 2-316A (West Supp. 1983); Vt. Stat. Ann. tit. 9A, § 2-316 (Supp. 1983); Wash. Rev. Code Ann. § 62A. 2-316 (Supp. 1983). All other states allow disclaimers. *See, e.g.*, Ala. Code § 7-2-316 (1975 & Supp. 1982); Fla. Stat. Ann. § 672.2-316 (West 1966 & Supp. 1983); N.Y.U.C.C. Law § 2-316 (McKinney 1964); Tex. Bus. & Com. Code Ann. § 2.316 (Vernon 1968 & Supp. 1982).

[34] *See, e.g.*, Vt. Stat. Ann. tit. 9A, § 1-105(1) (1966) (allowing parties contractually to select law; otherwise law of state with "appropriate relation" applies). The other 44 states allow disclaimers of the implied warranties of merchantability and fitness for a particular purpose in all situations, provided that certain conditions are met.

[35] *See, e.g.*, Wallis v. Mrs. Smith's Pie Co., 550 S.W.2d 453, 454, 458 (Ark. 1977) (when plaintiff was a resident of Arkansas, that state had predominant interest in apply-

the Mississippi policy because the states do require some relationship to the state, even if only the plaintiff's residence.

Mississippi's unique policy concerning disclaimers of the implied warranties of merchantability and fitness for a particular purpose, together with the requirement that this law apply to actions brought within Mississippi and the state's policy of allowing nonresident plaintiffs to sue foreign corporations doing business in the state on causes of action arising wholly outside the state,[36] may allow the Mississippi Legislature to subvert the policies of surrounding states by invalidating disclaimers that the bargaining parties contemplated as binding. This will most likely occur when two businesses have negotiated terms for the sale of equipment. If the seller is doing business in Mississippi, then the buyer may have any disclaimer of the implied warranties of merchantability and fitness for a particular purpose nullified simply by bringing the action in Mississippi, regardless of the buyer's residence or the situs of the transaction.

A. Cowan v. Ford Motor Co. Allows a Nonresident Plaintiff to Sue a Foreign Corporation Doing Business in Mississippi on a Cause of Action Arising Outside the State

In 1982, in *Cowan v. Ford Motor Co.*,[37] the United States Court of Appeals for the Fifth Circuit required the lower court to assert jurisdiction over a wrongful death claim brought by a Texas resident against a foreign corporation registered to do business in Mississippi although the cause of action arose wholly in Texas.[38] The Fifth Circuit examined a long line of Mississippi cases and concluded that Mississippi courts would allow a nonresident plaintiff to assert a claim that arose wholly outside the state against a foreign corporation doing business in Mississippi. The Fifth Circuit based its conclusion on Mississippi's policy of treating both domestic corporations and foreign corporations qualified to do business within the state as residents of Mississippi.[39] The court also decided that Mississippi could apply its

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ing its comparative fault statute, rather than Missouri's contributory negligence statute since "the truest governmental interest the forum has is in the fair and efficient administration of justice"); Schwartz v. Consol. Freightways Corp., 300 Minn. 487, 221 N.W.2d 665, 667 (1974) (Minnesota's comparative negligence statute applied when plaintiff was Minnesota resident, since economic impact of accident and subsequent litigation would be felt within the state's borders).

[36] *See infra* notes 37-42.

[37] 694 F.2d 104 (5th Cir. 1982).

[38] *Id.* at 105-07.

[39] *Id.* at 107. *See generally* Note, 53 MISS. L.J. 369, 374, 375-76 (1983) (tracing Mis-

six-year statute of limitations to the claim.[40] In holding that Mississippi could constitutionally assert *in personam* jurisdiction over these defendants, the court also stated that the application of Mississippi's statute of limitations did not undermine the sovereignty of Texas.[41] The court, however, indicated that its analysis might have been significantly different had Mississippi required application of its substantive law to the claim.[42] As a result of this decision, it is clear that both state courts and federal courts applying Mississippi law will assert jurisdiction over foreign corporations doing business in the state regardless of the plaintiff's residence and the state's contact with the claim.

B. "Doing Business" Statute, Section 79-1-27, Allows State to Assert Jurisdiction Over Corporate Defendants Not Qualified to Do Business in Mississippi.

Mississippi's "doing business" statute allows the state's courts to assert jurisdiction over corporations that have not qualified to do business but are found doing business in the state.[43] In a long line of cases, the Mississippi Supreme Court has evidenced a policy of doing just that. In *Pullman Palace-Car Co. v. Lawrence*,[44] an Illinois resident injured in Illinois sued an Illinois corporation in the Mississippi courts. The plaintiff claimed that an employee of the defendant railroad had assaulted him in Illinois. The defendant's only apparent connection with Mississippi was that it also operated a railway within the state.[45]

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sissippi policy of treating corporations qualified to do business in state as residents).

[40] 694 F.2d at 107. The two-year Texas statute of limitations had already run on the claim. *Id.* at 105. Mississippi has a six-year statute of limitations for negligence claims. See MISS. CODE ANN. § 15-1-49 (1972). For a discussion of the ramifications of the *Cowan* decision on the statute of limitations, see Note, *supra* note 39, at 379-80.

[41] 694 F.2d at 107.

[42] *Id.* The court pointed out that the analysis for application of a statute limitations and a substantive rule of law differed significantly. *Id.* The basis of the holding was that corporations which had qualified to do business in the state had consented to Mississippi's exercise of personal jurisdiction. *Id. See generally* Note, *supra* note 39, at 371-73, 379 (Ford Motor Company's Act of qualification to do business satisfied "minimum contacts" test required by *International Shoe*).

[43] The "doing business" statute provides:

> Any corporation claiming existence under the laws of any other state or of any other country foreign to the United States, found doing business in this state, shall be subject to suit here to the same extent that corporations of this state are, whether the cause of action accrued in this state or not.

MISS. CODE ANN. § 79-1-27 (1972).

[44] 74 Miss. 782, 22 So. 53 (1897).

[45] *Id.* at 791-94, 22 So. at 53-55.

In allowing the assertion of personal jurisdiction, the Court stated:

> [W]e had supposed there was, in our own state, no ground left for dispute that, in transitory actions, whether in tort or in contract, our courts were wide open to any suitor, resident or nonresident, against his adversary, whether resident or nonresident, whether a natural person or an artificial one, regardless of where the right of action occurred, if only the courts had jurisdiction of the subject-matter, and could obtain jurisdiction of the party, either by a voluntary appearance, or by service of process.[46]

The court also stated that this was, in fact, the rule in Mississippi, and that "neither citizenship nor residence is requisite to entitle a person to bring suit in our courts."[47] It was not apparent, however, whether this defendant had qualified to do business in Mississippi.

In *Vicksburg S. & P.R.R. v. Forcheimer*,[48] the Mississippi Supreme Court made explicit that qualification of the corporation was not determinative of the applicability of the longarm statute. The action was brought by an Illinois citizen against a Louisiana corporation. The plaintiff's cause of action was not specified nor were the defendant's contacts with the state. The court found that the corporation had an agent in Vicksburg, and was conducting a completely interstate business between Vicksburg and points in Louisiana. Consequently, the corporation was "doing business in the state within the meaning of the long-arm statute."[49] Since the statute relied upon in *Forcheimer* was virtually identical to section 79-1-27, it should be clear that the residence of the plaintiff is irrelevant under the current statute.[50]

The most recent Mississippi case dealing with section 79-1-27 is *Arrow Food Distributors, Inc. v. Love*,[51] an attachment suit in which a Louisiana resident (suing as conservator of a Mississippi estate) sued a Louisiana corporation on a cause of action arising from an accident that occurred in Louisiana. The plaintiff's decedent was killed by a truck en route to Mississippi to make a delivery of defendant's refrigerated foods. The corporation had been making similar deliveries in Mississippi for fifteen years.[52] The Mississippi Supreme Court sus-

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[46] *Id.* at 796-97, 22 So. at 55.

[47] *Id.* at 800, 22 So. at 57 (quoting Knight v. West S. R.R., 108 Pa. 250, 255 (1885)).

[48] 113 Miss. 531, 74 So. 418 (1917).

[49] *Id.* at 536-40, 74 So. at 419-20.

[50] *Compare* 1908 Miss. Laws ch. 123, *with* MISS. CODE ANN. § 79-1-27 (1972).

[51] 361 So. 2d 324 (Miss. 1978), *cert. denied*, 439 U.S. 1073 (1979).

[52] *Id.* at 326.

tained jurisdiction over the nonresident corporation, stating that sections 13-3-57 and 79-1-27 "must be read together" as "13-3-57 complements 79-1-27 in furthering the state's avowed policy . . . to 'open the doors' of our Mississippi courts to foreign corporations found doing business in this State to sue and be sued here on all bona fide causes of action."[53] The corporation apparently had not qualified to do business in Mississippi, since the court discussed the contacts of the corporation without mentioning its qualification. It appears, therefore, that a nonresident corporation doing business in Mississippi will be compelled to defend suits in the state, regardless of the lack of contacts of the plaintiff and the cause of action with Mississippi.

C. Ramifications of Applying Mississippi's Disclaimer Policy to These Corporations

In effect, section 75-1-105(1) of the Mississippi Code means that any disclaimer in any sale of goods in the United States may be invalidated so long as the defendant corporation is doing any business in Mississippi and the plaintiff files the action in the state. This result is inequitable to sellers who sold at a lower price than they otherwise would have. Although Mississippi's general policy of allowing any corporation doing business within the state to be sued here is beneficial because it enables individuals to reach businesses with whom they deal, application of the new conflicts provision to these corporations may have serious economic consequences. In effect, no corporation doing any business within the state of Mississippi can ever disclaim liability or create a limitation of remedy for the implied warranties of merchantability and fitness for a particular purpose with any certainty whatsoever, because it may be invalidated if the plaintiff has the foresight to file his suit in Mississippi. The seller may, therefore, have his obligations enlarged even though he gets no corresponding consideration for the additional burden. Section 75-1-105(1) thus is one of the most important of several factors that make Mississippi the ideal forum for a plaintiff's products liability action against a defendant doing

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[53] *Id.* at 327. The Fifth Circuit observed in Aycock v. Louisiana Aircraft, Inc., 617 F.2d 432, 435 (5th Cir. 1980), *cert. denied*, 450 U.S. 917 (1981) that:

> Arrow teaches us that businessmen who do business in Mississippi or Mississippi residents will be subject to personal jurisdiction in Mississippi courts [under both the long arm statute and the doing business statue] at least on causes of action *incident to* such business . . . regardless of whether the action arose from a purposeful act done in Mississippi.

Id. at 435. (emphasis in original).

business in the state. The conflicts provision effectively nullifies any disclaimer or limitation of remedy that the contract for the sale of the goods contained,[54] and Mississippi does not allow privity as a defense to claims against a manufacturer.[55] Finally, the state has a six-year statute of limitations for negligence actions[56] and for claims for breach of the implied warranty of merchantability.[57] Corporate defendants cannot avoid this result by having the case transferred because the plaintiff is allowed to retain any advantage that he may have had in the court in which the action was originally filed.[58] Consequently, Mississippi's laws on disclaimers, privity, and limitation of actions will follow the cause of action.

IV. Possibility of Unconstitutionality

This choice of laws provision appears to contravene the full faith and credit and due process clauses of the United States Constitution. Early United States Supreme Court decisions indicated that conflict of laws rules requiring application of the forum state's substantive law regardless of the state's contacts with the parties or transaction violated the fourteenth amendment's due process requirements.[59] Later decisions further indicate that a forum state must have a significant contact or aggregate of contacts before it may apply its substantive law to a case in its jurisdiction.[60] Section 75-1-105(1) mandates use of Mississippi law on disclaimers regardless of the extent of Mississippi's con-

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[54] *See supra* notes 27, 32-34 and accompanying text. Mississippi prohibits limitations of remedies for the implied warranties of merchantability and fitness for a particular purpose. Miss. Code Ann. § 11-7-18 (Supp. 1982), and the conflicts provision also mandates application of Mississippi law to limitations of remedies. *Id.* § 75-1-105(1) (Repl. 1981).

[55] Miss. Code Ann. § 11-7-20 (1983). *See* Volkswagen v. Novak, 418 So. 2d 801, 803-04 (Miss. 1982) (section 11-7-20 abolished privity for warranty actions, so manufacturer liable for breach even though not party to sales contract).

[56] Miss. Code Ann. § 15-1-49 (1972).

[57] *Id.* § 75-2-725 (1972).

[58] *See* Van Dusen v. Barrack, 376 U.S. 612, 639 (1964) (transferee court obligated to apply state law as if there had been no change of venue).

[59] *See, e.g.*, Hartford Accident & Indem. Co. v. Delta & Pine Land Co., 292 U.S. 143, 149-50 (1934) (striking down Mississippi contracts choice of law rules, saying a state "may not, on grounds of policy, ignore a right which has lawfully vested elsewhere, if, as here, the interest of the forum has but slight connection with the substance of the contract obligations").

[60] *See* Allstate Ins. Co. v. Hague, 449 U.S. 302, 320 (1981) (plurality opinion) (upholding application of Minnesota law because significant aggregation of contacts present).

tacts with the litigation.[61]

In *Home Insurance Co. v. Dick*,[62] the United States Supreme Court reversed a Texas court's decision to apply its substantive law in a contract dispute.[63] The only contact that Texas had with the litigation was that the plaintiff had moved into the jurisdiction after he had entered into the contract.[64] The effect of Texas statutory law was to invalidate a provision of the contract to which the parties had agreed, and which was valid in the place where the contract had been negotiated.[65] The Court held that a state could prohibit the making or performing of certain contracts within its own borders, but could not invalidate such contracts when the state lacked any contacts with the transaction, saying:

> As construed, [the state statute] also directs the disregard in Texas of contractual rights and obligations wherever created and assumed; and it commands the enforcement of obligations in excess of those contracted for . . . . [Texas'] attempt to impose a greater obligation than that agreed upon . . . violates the guaranty against deprivation of property without due process of law.[66]

The Supreme Court's analysis might well have been addressed to the Mississippi choice of laws provision contained in section 75-1-105(1) for implied warranties, because that statute also commands the invalidation of contractual provisions binding in the state in which the contract was signed and was to be performed and imposes obligations in

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[61] *See* MISS. CODE ANN. § 75-1-105(1) (Repl. 1981) (no provision for examining rationality of application of law to the litigation).

[62] 281 U.S. 397 (1930).

[63] *Id.* at 408.

[64] *Id.* at 403-04, 408.

[65] *Id.* at 407-08. An insurance contract, entered into in Mexico, where the plaintiff resided at the time, contained a clause requiring the insured to bring a suit against the insurer within one year of the loss, or be forever barred. *Id.* at 403. The plaintiff, then a Texas resident, filed his claim in the Texas court, more than one year after his loss occurred. Texas prohibited limitation clauses of less than 2 years duration in insurance contracts. *Id.* at 402-03. The state courts treated the agreed-upon limitation as the equivalent of a foreign statute of limitations and held that the Texas statute controlled, thereby allowing plaintiff to assert his claim. *Id.* at 405.

[66] *Id.* at 407-08. *Cf.* Bradford Elec. Light Co. v. Clapper, 286 U.S. 145, 151, 160 (1932) (where employment contract was entered into in Vermont, decedent had lived in Vermont, and death had occurred in New Hampshire, New Hampshire court erred in refusing to allow defendant to assert defense valid under Vermont law because "to refuse to give effect to a substantive defense under the applicable law of another state . . . subjects the defendant to irremediable liability").

"excess of those contracted for."[67]

Three years later, in *Hartford Accident & Indemnity Co. v. Delta & Pine Land Co.*,[68] the United States Supreme Court reversed the Mississippi Supreme Court decision applying Mississippi law to an action on a fidelity bond signed in Tennessee.[69] Both the plaintiff and the defendant were foreign corporations doing business in Mississippi and Tennessee. The bond was negotiated and entered into in Tennessee, where the law allows a contractual limitations period.[70] The fidelity bond specifically covered misappropriations by employees "in any position, anywhere."[71] One of the plaintiff's Mississippi-based employees stole some funds, and the plaintiff filed a suit on the fidelity bond in Mississippi, where contractual limitations on time to sue were prohibited.[72] The United States Supreme Court stated that application of Mississippi law to the case deprived the defendant of due process because:

> [a] state may limit or prohibit the making of certain contracts in its own territory . . . but it cannot extend the effect of its laws beyond its borders so as to destroy or impair the right of citizens of other states to make a contract not operative within its jurisdiction, and lawful where made . . . . Nor may it in an action based upon such a contract enlarge the obligations of the parties to accord with every local statutory policy solely upon the ground that one of the parties is its own citizen.[73]

Although the Supreme Court subsequently indicated that Mississippi did have sufficient contacts with the transaction to justify application of its own law, the Court's holding that an attempt by a state to affect transactions with which it has no significant contact violates the due process and full faith and credit clauses of the Constitution remains

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[67] *Cf.* Home Ins. Co. v. Dick, 281 U.S. 397, 407-08 (1930) *with* MISS. CODE ANN. § 75-1-105(1) (Repl. 1981).

[68] 292 U.S. 143 (1933).

[69] *Id.* at 145-46, 149.

[70] *Id.* at 144-48.

[71] *Id.* at 145.

[72] *Id.* at 145-46. A Mississippi statute provided that insurance contracts would be deemed made in the state if made to insure any property, life, or interest within the state. The bonded employee moved to Mississippi, where he defaulted, prompting the Mississippi court to find that an interest in Mississippi had been insured. That court reasoned that "this state is obligated to enforce it, as a Mississippi contract, although it contained all the elements necessary to make it a Tennessee contract, but for the statute." *Id.* at 148.

[73] *Id.* at 149. (citations omitted).

intact.[74]

Similarly, in *John Hancock Mutual Life Insurance Co. v. Yates*,[75] the United States Supreme Court determined that the full faith and credit clause of the Constitution required a forum state to give effect to a valid defense under the substantive law of a sister state if the contractual transaction had no relation to the forum state.[76] The Court stated that to hold otherwise "would irremediably subject the [defendant] to liability."[77]

The holdings in both *Dick* and *Yates* were recently reaffirmed in *Allstate Insurance Co. v. Hague*.[78] Although the Supreme Court upheld a Minnesota choice of laws rule that required application of its law to a dispute over an insurance policy because the state had sufficient contacts with the litigation,[79] the Court restated its position that absent a significant relationship, a forum state could not apply its law to a breach of contract action: "The lesson from *Dick* and *Yates*, . . . is that for a State's substantive law to be selected in a constitutionally permissible manner, that State must have a significant contact or significant aggregation of contacts, creating state interests, such that choice of its law is neither arbitrary nor fundamentally unfair."[80] The *Dick*, *Yates*, and *Hague* decisions all stand for the proposition that a state must have significant contacts with the litigation to constitution-

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[74] *See* Allstate Ins. Co. v. Hague, 449 U.S. 302, 308 n.11 (1981) (explaining *Hartford Accident* gave constitutional significance to signing contract in Tennessee, an event not currently controlling).

[75] 299 U.S. 178 (1936).

[76] *Id.* at 181-82. A life insurance policy had been issued in New York, where all the parties resided and where the insured died. The beneficiary filed a claim in Georgia for the proceeds. *Id.* at 179. The defendant asserted that material misrepresentations recorded in the policy about the insured's previous medical care were a valid defense under New York law. *Id.* at 179-80. In Georgia, the misrepresentations would have voided the policy only if the insured had actually written or given the misstatement. Georgia applied its own law and allowed the widow to recover the proceeds of the policy. *Id.* at 180.

[77] *Id.* at 183. The court considered that the substantive law of the state in which the contract was entered into became a part of the contract just as if it had been embodied in the agreement. *Id.*

[78] 449 U.S. 302 (1981). The court in *Hague* was split 4-1-3. *Id.*

[79] *Id.* at 320. Minnesota had three contacts, which, in the aggregate, were sufficient to allow it to apply its law: (1) plaintiff was a member of the Minnesota work force; (2) defendant was doing business in Minnesota; and (3) plaintiff became a Minnesota resident before instituting the litigation. *Id.* at 313-19.

[80] *Id.* 312-31. Similarly, in Clay v. Sun Ins. Office, 377 U.S. 179 (1964), the Supreme Court upheld Florida's imposition of its substantive law on a claim arising under an insurance policy issued in another state because the loss had occurred in Florida. *Id.* at 180-83. *See generally* 57 TUL. L. REV. 178, 183 (1982) (state with insufficient contacts to a contract cannot apply its law).

ally apply its law to a contract dispute. As the Mississippi statutory provision mandates the use of state law if the claim is filed in Mississippi regardless of the state's contacts and in spite of any consensual agreement concerning applicable law, it clearly goes far beyond the bounds of what is constitutionally permissible.

The United States Court of Appeals for the Eighth Circuit recently interpreted the *Hague* decision. In *McCluney v. Jos. Schlitz Brewing Co.*,[81] the court held that Missouri was constitutionally prohibited from applying its law to an employment contract negotiated and fully performed in another state, even though the plaintiff had become a Missouri resident prior to instituting the lawsuit,[82] and pointed out "[w]hen parties expectations are rationally based upon one state's laws, or in the negative, when their rational expectations are *not* based upon the laws of some other state, it violates due process to breach those expectations by applying the unexpected law."[83] This is precisely what section 75-1-105(1) requires. Clearly parties who negotiated and fully performed a contract for sale wholly within another state cannot have contemplated the use of Mississippi disclaimer law to future disputes.

V. Conclusion

Although the state conflict of laws rule may unjustly affect sellers, Mississippi practitioners stand to profit a great deal from the provision. Obviously, plaintiffs who purchase a defective product and agree to allow the seller to disclaim liability will desire to file suit in Mississippi. As the Mississippi provision becomes more widely known, the number of breach of implied warranty suits filed in the state should increase. This will, of course, necessitate the employment of Missis-

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[81] 649 F.2d 578 (8th Cir. 1981).

[82] *Id.* at 580-84. In applying the "significant contact or aggregation of contacts" test, the court implicitly rejected the rational basis test, which had been used before *Hague*. *See, e.g.*, Carroll v. Lanza, 349 U.S. 408, 412-13 (1955); Watson v. Employers Liab. Assurance Corp., 348 U.S. 66, 73 (1954); Pacific Employers Ins. Co. v. Industrial Accident Comm'n, 306 U.S. 493, 502-03 (1939).

[83] 649 F.2d at 582. The court also reasoned that a state that applied its law to a transaction with which it had no significant contact would be infringing upon the legitimate interest of the states that did have significant contacts with the transaction. *Id.*

Professor Weintraub has noted that an element of unfair surprise seems to have been a significant factor in *Home Insurance Company v. Dick* and a number of other Supreme Court decisions addressing the due process issue in choice of law cases. *See* Weintraub, *Due Process and Full Faith and Credit Limitations on a State's Choice of Law*, 44 Iowa L. Rev. 449, 454-60 (1959).

sippi attorneys on both sides of the litigation. Consequently, the provision should prove lucrative to local lawyers. Nevertheless, the center of gravity test is a reasonable one for both tort and contract actions, and the blanket application of Mississippi law to disclaimers and limitations of remedies is unfair to sellers, is probably unconstitutional, and will probably increase the number of lawsuits filed in Mississippi further burdening already overcrowded court dockets. Although the current conflicts provision easily could be amended to meet constitutional standards, the Legislature should not retain the provision at all, and the center of gravity test should be used for *all* tort and contract actions in Mississippi.

Janet Dixon McMurtray

DAMAGES RECOVERABLE IN MISSISSIPPI FOR THE WRONGFUL DEATH OF AN ADULT

I. Introduction

Section 11-7-13 of the Mississippi Code authorizes the personal representative of a decedent's estate and/or the beneficiaries named in the statute to bring a suit for damages against a defendant who is alleged to have, by wrongful acts or omissions, caused the death of the decedent.[1] In *Thornton v. Insurance Co. of North America*,[2] the Mis-

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[1] Miss. Code Ann. § 11-7-13 (Supp. 1981) provides in pertinent part:

Whenever the death of any person shall be caused by any real, wrongful or negligent act or omission . . . as would, if death had not ensued, have entitled the party injured or damaged thereby to maintain an action and recover damages in respect thereof . . . and such deceased person shall have left a widow or children or both, or husband or father or mother, or sister, or brother, the person or corporation, or both that would have been liable if death had not ensued, and the representatives of such person shall be liable for damages, notwithstanding the death, and the fact that death was instantaneous shall in no case affect the right of recovery. The action for such damages may be brought in the name of the personal representative of the deceased person for the benefit of all persons entitled under the law to recover, or by widow for the death of her husband, or by the husband for the death of the wife, or by the parent for the death of a child, or in the name of a child, or in the name of a child for the death of a parent, or by a brother for the death of a sister, or by a sister for the death of a brother, or by a sister for the death of a sister, or a brother for the death of a brother, or all parties interested may join in the suit, and there shall be but one (1) suit for the same death which shall ensue for the benefit of all parties concerned . . . . In such action the party or parties suing shall recover such damages as the jury may determine to be just, taking into consideration all the damages of every kind to the decedent and all damages of every kind to any and all parties interested in the suit . . . .

In an action brought pursuant to the provisions of this section by the widow, husband, child, father, mother, sister or brother of the deceased, or by all interested parties, such party or parties may recover as damages property damages and funeral, medical or other related expenses incurred by or for the deceased as a result of such wrongful or negligent act or omission or breach of warranty, whether an estate has been opened or not. Any amount, but only such an amount, as may be recovered for property damages, funeral, medical or other related expenses shall be subject only to the payment of the debts or liabilities of the deceased for property damages, funeral, medical or other related expenses. All other damages recovered under the provisions of this section shall not be subject to the payment of the debts or liabilities of the de-

sissippi Supreme Court reviewed the types of actions that may be brought under the Mississippi wrongful death statute. The court held that section 11-7-13 must be considered in conjunction with sections 91-7-231[3] and 91-7-233[4] of the Mississippi Code, since the wrongful death statute authorizes the deceased's personal representative to bring an action "for the benefit of all persons entitled under the law to recover."[5] Sections 91-7-231 and 91-7-233 permit *only* the personal representative of a decedent to bring an action for recovery of damages that are considered to be assets of the decedent's estate.[6] Therefore, section 11-7-13 creates a new cause of action which arises upon the

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ceased, except as hereinafter provided . . . .

[2] 287 So. 2d 262 (Miss. 1973). In *Thornton,* the decedent's death ensued from the collision of his automobile with a tractor and cotton trailer. *Id.* at 263. Plaintiffs, the wife and minor daughter of the deceased, brought suit against the tractor operator and his employer under MISS. CODE ANN. § 11-7-13. Damages were sought as compensation for physical pain and suffering of decedent, loss of companionship and society, loss of decedent's future earnings, medical and funeral expenses, punitive damages, and all other losses caused by the decedent's death. 287 So. 2d at 263-64. A consent judgment was entered in favor of the plaintiffs in the sum of $90,000, and the wife executed various releases totalling this amount. At the time of the collision, the decedent was insured by the Insurance Company of North America (INA). The policy insured the decedent against liability for bodily injury and property damage and provided for medical payments and accidental death benefits. Pursuant to this policy INA paid decedent's wife $1,500 (for which she executed a subrogation agreement), $1,000, and $614.45 representing property damage to the automobile, death benefits, and medical and funeral expenses, respectively. *Id.* at 264. INA filed suit against Mrs. Thornton, alleging that she had breached the subrogation agreement and the subrogation provisions of the policy by consenting to the $90,000 judgment, thereby precluding INA from collecting the subrogated claims under the policy. *Id.* at 264-65.

The Mississippi Supreme Court ruled in favor of the decedent's wife, reasoning that in a suit brought by such statutory beneficiaries as the wife and minor daughter, any judgment recovered would not include medical, hospital, funeral, and property damage costs; therefore, INA's subrogation rights were not affected by the consent judgment. *Id.* at 268.

[3] MISS. CODE ANN. § 91-7-231 (1972) provides that "[a]n executor, administrator, or temporary administrator may maintain any action or suit which shall accrue to him in the due course of administration, on any contract which he is authorized to make as such, or for the recovery of personal property, or for injuries thereto."

[4] MISS. CODE ANN. § 91-7-233 (1972) states in pertinent part that "[e]xecutors, administrators, and temporary administrators may commence and prosecute any personal action whatever, at law or in equity, which the testator or intestate might have commenced and prosecuted . . . ."

[5] 287 So. 2d at 266. *See* MISS. CODE ANN. § 11-7-13 (Supp. 1981).

[6] 287 So. 2d at 266. Sections 91-7-231 and 91-7-233 make no mention of the deceased's heirs in delineating those who can sue to recover assets of the deceased's estate, e.g., property damages, hospital and medical expenses, and funeral expenses. *See supra* notes 3 and 4.

death of the deceased in favor of the beneficiaries named in the statute and which is separate and distinct from a suit brought to recover assets of the deceased's estate.[7]

As a result of the *Thornton* decision, actions arising from the wrongful death of a decedent may be brought in several different ways. The type of damages recoverable in each depends on the identity of the party or parties bringing suit. A beneficiary, or beneficiaries, named in the wrongful death statute may bring *one* action for damages occasioned by the wrongful death of the deceased on behalf of all other survivors so named.[8] In this action, recovery may be had for all damages that the deceased could have recovered had he lived and also for all damages suffered by the beneficiaries which flow from the loss of their personal relationships with the deceased.[9] Such damages have been held to include: (1) the present net cash value of the life expectancy of the decedent;[10] (2) loss of the companionship and society of the decedent;[11] (3) pain and suffering of the decedent between the time

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[7] 287 So. 2d at 266. The *Thornton* court here cited Byars v. Austin, 218 So. 2d 11 (Miss. 1969), in which it was stated:

> In Mississippi we have adhered to the . . . theory that the "wrongful death statute" creates an entirely new cause of action for the benefit of the persons named in the act, and is not a part of the estate of the deceased . . . .
>
> It is clear, at least in this state, that a cause of action by the administrator of an estate for the assets of an estate, and a suit in the name of the administrator for the use and benefit of the widow and persons named in the "wrongful death statute" are distinct causes of action and are unrelated although they grow out of the results of the wrongful death of the decedent.

218 So. 2d at 15-16.

[8] 287 So. 2d at 266.

[9] *Id. See* Scott v. K-B Photo Serv., Inc., 260 So. 2d 842, 844 (Miss. 1972) (limitation of damages to those recoverable by decedent if not dead and those suffered by heirs as a result of loss of the decedent); St. Louis and S.F. R.R. Co. v. Moore, 101 Miss. 768, 780, 58 So. 471, 475 (1912) (types of damages recoverable in a wrongful death action to be determined only by reference to the wrongful death statute); *see also* MISS. CODE ANN. § 11-7-13 (Supp. 1981) ("In such action the party or parties suing shall recover such damages as the jury may determine to be just, taking into consideration all the damages of every kind to the decedent and all damages of every kind to any and all parties interested in the suit").

[10] *See* Sheffield v. Sheffield, 405 So. 2d 1314, 1318 (Miss. 1981); Dickey v. Parham, 331 So. 2d 917, 918-19 (Miss. 1976); Avery v. Collins, 171 Miss. 636, 649, 157 So. 695, 699 (1934); *cf.* Moore v. Johnson, 148 Miss. 827, 833, 114 So. 734, 735 (1927).

[11] *See* Dickey v. Parham, 295 So. 2d 284, 285 (Miss. 1974), *appeal after remand*, 331 So. 2d 917, 918 (Miss. 1976); Thornton v. Insurance Co. of North America, 287 So. 2d 262, 265 (Miss. 1973) (society and companionship recovered by heirs because of loss); Scott v. K-B Photo Serv., Inc., 260 So. 2d 842, 844 (Miss. 1972); Boyd Constr. Co. v. Bilbro, 210 So. 2d 637, 643 (Miss. 1968); Avery v. Collins, 171 Miss. 636, 649, 157 So. 695, 699 (1934); Moore v. Johnson, 148 Miss. 827, 833, 114 So. 734, 735 (1927); St. Louis and

of injury and death, if any;[12] and (4) punitive damages.[13] Damages of this character that are recovered by surviving beneficiaries are not subject to the claims of creditors of the estate of the deceased.[14] Should a party listed in the statute as a beneficiary release a defendant from damages recoverable for the decedent's wrongful death, only those elements of damage to which beneficiaries have been held to be entitled may be included. The recovery will not include damages owed to the estate of the deceased.[15]

The personal representative of the estate of the deceased is allowed to bring a suit separately to recover damages which are assets of the deceased's estate and which arise from the wrongful death of the deceased.[16] Amounts recoverable as charges against the decedent's estate include funeral expense,[17] cost of a tombstone,[18] damages to real or personal property,[19] medical expenses,[20] and costs of administration of the deceased's estate.[21] Such damages are subject to the claims of creditors against the estate.[22]

A suit may also be brought by the personal representative of an

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S.F. R.R. v. Moore, 101 Miss. 768, 780, 58 So. 471, 475 (1912). It should be noted that while the beneficiaries may recover damages for the loss of the decedent's society and companionship, they may not recover damages as consolation for the loss of the decedent. *See* Goodyear Yellow Pine Co. v. Anderson, 171 Miss. 530, 537, 157 So. 700, 701 (1934); *infra* note 77 and accompanying text.

[12] *See* Thornton v. Insurance Co. of North America, 287 So. 2d 262, 265 (Miss. 1973); Boyd Constr. Co. v. Bilbro, 210 So. 2d 637, 640 (Miss. 1968); Gordon v. Lee, 208 Miss. 21, 34, 43 So. 2d 665, 667 (1950); Murry Chevrolet Co. v. Cotten, 169 Miss. 521, 530, 152 So. 657, 659 (1934); New Deemer Mfg. Co. v. Alexander, 122 Miss. 859, 898, 85 So. 104, 107 (1920); S.H. Kress Co. v. Markline, 117 Miss. 37, 61, 77 So. 858, 866 (1918); Cumberland Tel. & Tel. Co. v. Anderson, 89 Miss. 732, 745, 41 So. 263, 264 (1906).

[13] *See* Thornton v. Insurance Co. of North America, 287 So. 2d 262, 265 (Miss. 1973); Young v. Columbus & G. Ry., 165 Miss. 287, 294, 147 So. 342, 343 (1933); Alabama & V. Ry. v. Kelly, 126 Miss. 276, 287, 88 So. 707, 709 (Miss. 1921); St. Louis & S.F. R.R. v. Moore, 101 Miss. 768, 775, 58 So. 471, 472-73 (1912).

[14] Thornton v. Insurance Co. of North America, 287 So. 2d 262, 265-66. *See* Scott v. K-B Photo Serv., Inc., 260 So. 2d 842, 844 (Miss. 1973) (beneficiaries not required to pay funeral costs out of damages recovered in wrongful death suit); MISS. CODE ANN. § 11-7-13 (Supp. 1981).

[15] Thornton v. Insurance Co. of North America, 287 So. 2d 262, 267-68 (Miss. 1973).

[16] *Id.* at 266.

[17] *Id.* at 266-67. *See* Scott v. K-B Photo Serv., Inc., 260 So. 2d 842, 844 (Miss. 1972) (recovery allowed of funeral expenses specifically owed by estate of deceased).

[18] 287 So. 2d at 265.

[19] *Id.* at 267.

[20] *Id.*

[21] *Id.* at 265.

[22] *Id.*

estate on behalf of himself as administrator of that estate and on behalf of the surviving beneficiaries of the deceased.[23] All damages of every kind allowed under the statutes are recoverable in such an action.[24] However, the relief sought in the complaint should be laid out in two counts, one with reference to damages recoverable by the named beneficiaries under section 11-7-13 and the other with reference to those items recoverable as assets of the estate of the deceased.[25] Also, the trier of fact should make its awards of damages separately.[26] This simplifies the bifurcation of the damage award into its two components: that portion which is subject to the debts and liabilities owed by the deceased's estate and that portion which is not.[27] If such a suit is settled, the settlement agreement should list the damages respectively, clearly distinguishing between sums awarded to the decedent's estate and amounts intended to be compensation for the surviving beneficiaries.[28]

In a case in which the deceased is not survived by any of the beneficiaries named in section 11-7-13, the deceased's personal representative is authorized to bring an action for recovery of all elements of damages aforementioned.[29] By statute, the entire amount awarded in such a suit is subject to charges levied by creditors on the estate of the decedent.[30] The balance that remains after payment of any outstanding debts and liabilities of the estate is subject to apportionment in accordance with the general distribution provisions of the wrongful death statute.[31]

II. Elements of Damage Sanctioned by Section 11-7-13

The Mississippi Supreme Court has concluded that the items of damages recoverable by the named beneficiaries in a wrongful death

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[23] *Id.* at 266-67.

[24] *Id.* "A suit by the personal representative of the deceased should include damages that would be assets of the estate as well as damages to the persons listed in the statute who take their damages free from the debts and liabilities of the deceased." *Id.* at 267.

[25] *Id.*

[26] *Id.* at 267.

[27] *Id.*

[28] *Id.*

[29] *Id.*

[30] *Id.* Miss. Code Ann. § 11-7-13 (Supp. 1981) states that "[i]f the deceased have neither husband, nor wife, nor children, nor father, nor mother, nor sister, nor brother, then the damages shall go to the legal representative, subject to debts and general distribution . . . ." *Id.*

[31] 287 So. 2d at 267. *See* Miss. Code Ann. § 11-7-13 (Supp. 1981).

action must be determined only by reference to the statutory law of this state.[32] Section 11-7-13 states that "[i]n such action the party or parties suing shall recover such damages as the jury may determine to be just, taking into consideration all the damages of every kind to the decedent and all damages of every kind to any and all parties interested in the suit."[33] By creating a cause of action for damages in which specific survivors can recover a monetary amount representing the value of the deceased's life, the wrongful death statute manifests an intent to compensate named persons for their loss.[34] However, this statute is not intended to allow the survivors to profit from the decedent's death.[35]

There is no specific minimum or maximum amount of damages that may be awarded in a wrongful death action.[36] The decision as to the proper amount to be awarded must be made by the trier of fact in its discretion, considering the facts and circumstances of each particular case.[37] Statements made by the supreme court suggest that, in making its determination, the trier may take into account the effect of inflation upon the efficacy of a damage award.[38]

The task of reviewing the adequacy of a damage award presents the supreme court with complex problems due to the inherent diffi-

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[32] St. Louis & S.F. R.R. v. Moore, 101 Miss. 768, 780, 58 So. 471, 475 (1912).

[33] MISS. CODE ANN. § 11-7-13 (Supp. 1981).

[34] Gordon v. Lee, 208 Miss. 21, 34, 43 So. 2d 665, 667 (1950) (*citing* New Deemer Mfg. Co. v. Alexander, 122 Miss. 859, 898, 85 So. 104, 107 (1920)). Although *Gordon v. Lee* involved the wrongful death of a 5-year-old child, the intent and purpose of the statute is identical in the case of an adult decedent. This is evidenced by the cite to *New Deemer Mfg. Co. v. Alexander,* in which statutory beneficiaries recovered damages for the death of a husband and father. *See* 122 Miss. at 898, 85 So. at 107.

[35] Avery v. Collins, 171 Miss. 636, 648, 157 So. 695, 699 (1934). In the context of the beneficiaries' ability to recover the present net value of the decedent's life expectancy, the court stated that the purpose of the wrongful death statute is only to compensate named beneficiaries for their loss caused by the deceased's death. *Id.,* 157 So. at 699. The court specifically pointed out that there is no policy permitting the beneficiaries to profit monetarily from their loss. *Id.,* 157 So. at 699.

[36] Illinois Cent. R.R. v. Ragan, 252 Miss. 335, 340, 173 So. 2d 433, 435 (1965). The court, in *Illinois Cent. R.R. v. Ragan,* made the frequently-quoted statement that "[t]here is no mathematical formula by which such damages can be ascertained." *See id.,* 173 So. 2d at 435; *see also* Dickey v. Parham, 295 So. 2d 284, 285 (Miss. 1974).

[37] 252 Miss. at 340, 173 So. 2d at 435.

[38] Boyd Constr. Co. v. Bilbro, 210 So. 2d 637, 644-45 (Miss. 1968) (dictum). In considering whether award of $92,500 was excessive, the court discussed the effects of inflation on the present purchasing power of the dollar. It was noted that other states specifically allow their juries to consider inflation when calculating the proper amount of a damage award. *See id.*

culty of valuing human life.[39] Previous opinions of the court give general guidance, but once again, the decision is essentially one which must be made on an ad hoc basis.[40] Nevertheless, a damage award should be logical and reasonable in relation to the loss incurred by the statutory beneficiaries.[41] If a verdict is contrary to the weight of the evidence in the record, it cannot be sustained.[42]

A. Present Net Cash Value of Decedent's Life Expectancy

Although not mentioned specifically in section 11-7-13, the present net cash value of the deceased's life expectancy is an element of damage recoverable by the beneficiaries of the deceased under the wrongful death statute.[43] Under basic tort theories of damages, the value of lost life expectancy alone is generally not recoverable as an element of damages.[44] Therefore, the present net cash value award must be measured by the deceased's earning capacity in the context of loss of support to the beneficiaries.[45]

In *Hines v. Green*,[46] the Mississippi Supreme Court first outlined the method to be followed in arriving at a measure of damages based upon the life expectancy and the earning capacity of the deceased.[47]

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[39] *Id.* Dickey v. Parham, 331 So. 2d 917, 919 (Miss. 1976). "[H]ow to test the adequacy or inadequacy of verdicts in a wrongful death action is a most perplexing problem. This is true because the value of human life even when considered along with applicable elements of damages is difficult of proof." *Id.*

[40] *See* Dickey v. Parham, 295 So. 2d at 285.

[41] Dickey v. Parham, 331 So. 2d at 919.

[42] Dickey v. Parham, 295 So. 2d at 285. "[W]hen it appears from the evidence that the amount of the verdict bears no reasonable relation to the loss suffered and manifests a miscarriage of justice or is palpably against the weight of the evidence, then this Court will set it aside." *Id.*

[43] *See e.g.*, Sheffield v. Sheffield, 405 So. 2d 1314, 1318 (Miss. 1981) (present net value of deceased's life expectancy is proper element of damages); Avery v. Collins, 171 Miss. 636, 649, 157 So. 696, 699 (1934) (same); Moore v. Johnson, 148 Miss. 827, 833, 114 So. 734, 735 (1927) (same); New Deemer Mfg. Co. v. Alexander, 122 Miss. 859, 896, 85 So. 104, 107 (1920) (same).

[44] *See* W. PROSSER, HANDBOOK OF THE LAW OF TORTS 905-07 (1971). *But see* Downie v. United States, 359 F.2d 344, 348 (3d Cir. 1966)(damages awarded to compensate for shortened life expectancy).

[45] *See* W. PROSSER, *supra* note 44, at 905-07.

[46] 125 Miss. 476, 87 So. 649 (1921).

[47] *Id.* at 498, 87 So. at 653. The method used in *Hines* for calculating the present net cash value of the decedent's life expectancy was applied as follows:

> The expectancy of the deceased was 29.62 years, and he was a healthy man both in mind and body, and was earning $5 per day. This would amount to $1,825 per year. The evidence does not contain any calculation of the expec-

The total cash amount that would have been earned over the controlling life expectancy is determined by first calculating the amount of wages, salary, or other compensation for services that the decedent earned per year.[48] This amount is then multiplied by the number of years of the controlling life expectancy.[49] The result will be the total cash amount of the life expectancy, i.e., the amount the decedent would have earned if his expected life span not been cut short.[50] The total amount of the expectancy is then divided by one plus the prevailing non-contract rate of interest for the length of time of the controlling expectancy, which yields the "gross net value"[51] of the expectancy.[52] From this value, an amount must be deducted which represents the expenses that the decedent would have incurred in supporting *himself* over the length of the controlling life expectancy.[53] Such a deduction must be made because the beneficiaries cannot recover more than the deceased would have contributed to their support had death not intervened.[54] The amount of recovery permitted the beneficiaries thus represents the present net cash value of support lost because of the decedent's death over the length of the controlling life

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> tancy, nor are any tables introduced by which computation may be made according to any standard, recognized mortality tables. But, finding the present value by dividing the total expectancy, if earned, by one plus 6 per cent, the legal rate of interest, for the average number of years of the expectancy, which in the absence of other proof we will apply in this case, we find that the gross net value is approximately $24,000, from which must be deducted the expenses that would have been incurred by the deceased on his own account in living and supporting himself during the period of his expectancy, which would doubtless have amounted to at least $50 per month, and we think that the highest verdict that could be upheld on the elements of damage involved in the trial would be $16,000.

Id., 87 So. at 653. This passage from *Hines* was cited with approval in Louisville & N.R.R. v. Garnett, 129 Miss. 795, 807, 93 So. 241, 243 (1922).

[48] Hines v. Green, 125 Miss. at 498, 87 So. at 653.

[49] *Id.*, 87 So. at 653. For an explanation of the phrase "controlling life expectancy," see *infra* note 56 and accompanying text.

[50] Hines v. Green, 125 Miss. at 498, 87 So. at 653.

[51] *Id.*, 87 So. at 653.

[52] *Id.*, 87 So. at 652.

[53] *Id.*, 87 So. at 653. *See also* Sheffield v. Sheffield, 405 So. 2d 1314, 1318 (Miss. 1981)(decedent's living expenses to be deducted from the present net cash value of his life); MISS. MODEL JURY INSTRUCTION No. 20.21 (1977) (the amount that the deceased "would have spent on [his/her] own personal living expenses" must be subtracted from the projected gross annual income of the deceased).

[54] Louisville & N. R.R. v. Garnett, 129 Miss. 795, 807, 93 So. 241, 243 (1922). If the decedent's living expenses were not deducted from the present net value award, the deceased would be more valuable to the beneficiaries when dead than when alive. *Id.*

expectancy, rather than the gross amount of compensation that the decedent would have earned.[55]

It is the rule in Mississippi that the controlling life expectancy period to be used in calculating the present net cash value award of damages is the life expectancy of the deceased only if that is shorter than the life expectancy of the suing beneficiary.[56] If the life expectancy of such beneficiary is shorter than that of the deceased, then that beneficiary's life expectancy must be used as the basis for the calculation.[57] This limitation is reasonable since the beneficiary would receive a windfall in excess of compensation if he were to recover damages measured on a basis longer than his own life expectancy.

In *Dickey v. Parham*,[58] the Mississippi Supreme Court considered the issue of an award of damages for gratuities lost to the beneficiaries as a result of the wrongful death of a decedent. In *Dickey*, the decedent's mother and other statutory beneficiaries were awarded damages for the present net cash value of the decedent's life expectancy, in addition to gratuities that a parent could reasonably expect to receive from a child.[59] The present net cash value was calculated on the basis of the decedent's expected annual salary as his only source of income.[60] The court held that the value of any gratuities that the decedent might have given the beneficiaries in the future was already included in the present net cash value award, and such gratuity value could not properly be added to the recovery a second time.[61] It is arguable, however,

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[55] *Id.*, 93 So. at 243.

[56] Goodyear Yellow Pine Co. v. Anderson, 171 Miss. 530, 536, 157 So. 700, 701 (1934).

[57] *Id.*, 157 So. at 701.

[58] 331 So. 2d 917 (Miss. 1976).

[59] *Id.* at 918. The award also included damages for loss of society and companionship. *Id.*

[60] *Id.*

[61] *Id.* The court reasoned that it would be "pyramiding" of damages to allow both the gratuities a beneficiary reasonably expected to receive and a sum representing the deceased's present net value of life expectancy. *Id.* In New Deemer Mfg. Co. v. Alexander, 122 Miss. 859, 85 So. 104 (1920), the trial court gave the following jury instruction concerning present net cash value and the value of gratuities that the beneficiaries might reasonably have expected:

> The court instructs the jury for the plaintiffs that should they find for the plaintiffs they should award them such an amount as the jury may believe from the evidence will be reasonable compensation. For such amount as the jury may believe from the evidence is the present value of the amount [decedent] would have earned, if any, during the remainder of his life, had he not lost his life . . . . And in addition thereto, shall award the present value of any support which the jury may believe from the evidence that [the decedent]

that the opposite result should be reached if the decedent is possessed of a source of income, independent of his salary or wages, from which gifts are shown to have been made to the beneficiaries in the past. In such a case, the value of gratuities reasonably expected by the beneficiaries would not be represented in a present net cash value award, which is calculated on the basis of earning capacity over the controlling life expectancy.[62] It would seem, then, that a separate sum for gratuities which reasonably could have been anticipated by the beneficiaries over the period of the controlling life expectancy could properly be added to the damage award.

If an award for the present net cash value of the deceased's life expectancy is to be made at trial, it is necessary that certain evidence be presented to enable the trier of fact to make the calculation. The Mississippi courts have recognized the accuracy of standard insurance mortality tables, and these may be introduced as evidence in the computation of the controlling life expectancy.[63] Other items of evidence that are relevant to determining the proper amount of a present net cash value award are: (1) age of the deceased;[64] (2) ages of the beneficiaries;[65] (3) the degree of dependency of any children;[66] (4) the amount of the deceased's earnings, if any, from employment;[67] (5) the employment status, if any, of the deceased's spouse;[68] (6) the deceased's health;[69] (7) the deceased's level of education and any proba-

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would have given to his children until they reached their majority, provided the jury believes from the evidence that the [decedent] and the said children would have lived until said children reached their majority. And, in addition thereto, such an amount, if any, as the jury may believe from the evidence will be reasonable compensation for the present value of any amounts which the jury may believe from the evidence that the [decedent] would have given to his wife during the remainder of his natural life for her maintenance and support providing the jury believe from the evidence that his wife would have lived as long as [decedent].

122 Miss. at 895, 85 So. at 106.

This instruction was held to be erroneous because it allowed the jury to award a sum greater than the amount the decedent would have earned and contributed to the beneficiaries' support during his lifetime. *Id.* at 896, 85 So. at 107.

[62] *See supra* notes 46-55 and accompanying text.

[63] Louisville & N.R.R. v. Garnett, 129 Miss. 795, 807, 93 So. 241, 243 (1921).

[64] *See* Dickey v. Parham, 295 So. 2d 284, 286 (Miss. 1974); Illinois Cent. R.R. v. Ragan, 252 Miss. 335, 341, 173 So. 2d 433, 435 (1965).

[65] Illinois Cent. R.R. v. Ragan, 252 Miss. 335, 341, 173 So. 2d 433, 435 (1965).

[66] *Id.*, 173 So. 2d at 435.

[67] Dickey v. Parham, 295 So. 2d 284, 286 (Miss. 1974).

[68] Illinois Cent. R.R. v. Ragan, 252 Miss. 335, 341, 173 So. 2d 433, 435 (1965).

[69] Goodyear Yellow Pine Co. v. Anderson, 171 Miss. 530, 536, 157 So. 700, 701

ble salary increases resulting from it;[70] (8) if employed, the increase, if any, in income over a period of the decedent's working years;[71] and (9) the manner in which the decedent generally spent his earnings.[72] An expert witness should be retained to testify, among other things, as to the deceased's average salary over his expected working life, and the amount of a lump sum annuity at a particular rate of investment that would be necessary to yield that average salary over the working life span.[73]

The Mississippi theory for recovery for loss of support, in the form of the present net cash value of life expectancy, generally achieves the objective of compensating the beneficiaries in cases where the decedent dies almost immediately after being injured. Because the amount that the decedent would have earned had he lived is, by definition, measured from the time of death, the beneficiaries in such a case are fully compensated. When there is a substantial time lapse between the time of the decedent's injury and his death, however, there is also a gap in the compensation provided to the beneficiaries for loss of support. In the case of an injury that is severe enough to eventually cause death, it is doubtful that the decedent is physically capable of earning any wages between the time of injury and the time of death. Thus, the decedent loses earnings during this period, and the beneficiaries lose the decedent's support. Yet, compensation under section 11-7-13 for the present net cash value of life expectancy is defined as including the amount the decedent would have earned *had he lived,* less the amount that would have been necessary for the decedent's own support.[74] Thus, the beneficiaries will receive no compensation for the potentially lengthy period between the injury and death.

B. Loss of Society and Companionship

The Mississippi Supreme Court has held that in an action under section 11-7-13, the named beneficiaries can recover damages that they suffered as a result of the loss of "their personal relationship with the

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(1934); Murry Chevrolet v. Cotten, 169 Miss. 521, 530, 152 So. 657, 659 (1934).

[70] Dickey v. Parham, 295 So. 2d 284, 286 (Miss. 1974).

[71] *Id.*

[72] Goodyear Yellow Pine Co. v. Anderson, 171 Miss. 530, 538, 157 So. 700, 702 (1934).

[73] Dickey v. Parham, 295 So. 2d 284, 286 (Miss. 1974). An expert's testimony is advisory only, and the court is not bound by it. *Id.* In practice, an economist or other expert witness will be called to testify as to the amount of the decedent's present net life expectancy value, including all elements necessary in making such a calculation. *See id.*

[74] 129 Miss. at 807, 93 So. at 243.

deceased . . . ."[75] The section contemplates recovery of damages for loss of the companionship, protection, and society of the decedent.[76] However, the beneficiaries may not recover compensation for their own emotional grief and suffering resulting from the deceased's death.[77]

The trier of fact must use its discretion in estimating the value of the loss of companionship, protection, and society in a pecuniary context according to the evidence presented in each particular case.[78] Relevant items of evidence for the trier of fact to consider in making its determination of the proper amount to award are: (1) the behavior, character, and habits of the deceased;[79] (2) if the deceased was married, the quality of the marital relationship between the deceased and his or her spouse before and at the time of death;[80] (3) the closeness of the relationship between the deceased and any other family members;[81] (4) and the services rendered by the decedent in assisting in his or her family's care.[82] The sum awardable is in no way restricted by the amount that a decedent may have actually earned from employment.[83]

Because of the lack of an objective standard for estimating the proper amount to award for such injury, the sums representing recov-

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[75] Thornton v. Insurance Co. of North America, 287 So. 2d 262, 265 (Miss. 1973).

[78] *See, e.g.*, Dickey v. Parham, 295 So. 2d 284, 285 (Miss. 1974) (damages recoverable for loss of society and companionship); Thornton v. Insurance Co. of North America, 287 So. 2d 262, 265 (Miss. 1973) (same); Boyd Constr. Co. v. Bilbro, 210 So. 2d 637, 643 (Miss. 1968) (same); Goodyear Yellow Pine Co. v. Anderson, 171 Miss. 530, 537, 157 So. 700, 701 (1934) (same); Murry Chevrolet Co. v. Cotten, 169 Miss. 521, 530, 152 So. 657, 659 (1934) (same); St. Louis & S.F. R.R. v. Moore, 101 Miss. 768, 780, 58 So. 471, 475 (1912) (same).

[77] Goodyear Yellow Pine Co. v. Anderson, 171 Miss. 530, 538, 157 So. 700, 702 (1934). In *Goodyear*, the court stated that a widow could recover damages for loss of the society and companionship of the deceased husband. *Id.* at 537, 157 So. at 701. No amount, however, could be awarded for mental anxiety, grief, and distress. *See id.* at 538, 157 So. at 702; *see also* St. Louis & S.F. R.R. Co. v. Moore, 101 Miss. 768, 780, 58 So. 471, 475 (1912) (same).

[78] *See* Goodyear Yellow Pine Co. v. Anderson, 171 Miss. 530, 537, 538, 157 So. 700, 701, 702 (1934) (citing St. Louis & S.F. R.R. v. Moore, 101 Miss. 768, 780, 58 So. 471, 475 (1912)).

[78] St. Louis & S.F. R.R. v. Moore, 101 Miss. 768, 780, 58 So. 471, 475 (1912).

[80] *Id. See also* Illinois Cent. R.R. Co. v. Ragan, 252 Miss. 335, 341, 173 So. 433, 435 (1965) (relevant evidence included marital relationship of deceased to spouse).

[81] Dickey v. Parham, 295 So. 2d 284, 286 (1974).

[82] Goodyear Yellow Pine Co. v. Anderson, 171 Miss. 530, 538, 157 So. 700, 701 (1934). *See also* Boyd Constr. Co. v. Bilbro, 210 So. 2d 637, 643 (Miss. 1968)(recovery of damages by minor children allowed for loss of moral training and care that deceased mother would have provided during their minority had she lived).

[83] Goodyear Yellow Pine Co. v. Anderson, 171 Miss. 530, 538, 157 So. 700, 702 (1934).

ery for loss of companionship, society, and protection may vary greatly from case to case. Once again, there is no mathematically precise way to calculate damages resulting from this type of harm to the beneficiaries,[84] and the case law presents no guidelines concerning specific minimum or maximum amounts that may be allowed.[85] Prior case law is useful only to provide general guidelines,[86] and it is often difficult to determine what part of the total amount of damages awarded by a jury is intended as compensation for loss of companionship, protection, and society.[87]

C. *Mental and Physical Suffering of the Decedent*

Under section 11-7-13, the named beneficiaries can recover "all the damages of every kind to the decedent . . . ."[88] The Mississippi Supreme Court has stated that this encompasses damages for any mental and physical pain and suffering experienced by a decedent between the time of injury and the time of death.[89] In a wrongful death action, however, there are limitations upon the availability of such recovery. Where the decedent dies instantaneously upon injury, the beneficiaries may not recover damages for mental and physical pain.[90] Also, when the decedent is completely unconscious from the time of injury until the time of death, damages for physical and mental suffering are generally not allowed.[91] In such a situation, the assumption that the de-

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[84] *See supra* notes 36-37 and accompanying text.

[85] *Id.*

[86] *See supra* note 40 and accompanying text.

[87] Most Mississippi courts adhere to the practice of allowing the form of the jury's verdict to be general, rather than special, thus rendering virtually indiscernible that part of the award intended to compensate the survivors for loss of society and companionship. *See* Miss. R. Civ. P. 49(b) comment (special verdicts allowed, but seldom used).

[88] *See* MISS. CODE ANN. § 11-7-13 (Supp. 1981).

[89] *See, e.g.*, Thornton v. Insurance Co. of North America, 287 So. 2d 262, 265 (Miss. 1973) (recovery by mother and daughter for deceased's pain and suffering); Gordon v. Lee, 208 Miss. 21, 34, 43 So. 2d 665, 667 (1950) (pain and suffering of decedent between injury and death is compensable); Murry Chevrolet Co. v. Cotten, 169 Miss. 521, 530, 152 So. 657, 659 (1934) (same); New Deemer Mfg. Co. v. Alexander, 122 Miss. 859, 898, 85 So. 104, 107 (1920) (same); Cumberland Tel. & Tel. Co. v. Anderson, 89 Miss. 732, 745, 41 So. 263, 264 (1906) (same).

[90] *See, e.g.*, Yazoo and M.V. R.R. v. Lee, 148 Miss. 809, 823, 114 So. 866, 869 (1928); Moore v. Johnson, 148 Miss. 827, 833, 114 So. 734, 735 (1927); New Deemer Mfg. Co. v. Alexander, 122 Miss. 859, 898, 85 So. 104, 107 (1920); St. Louis & S.F. R.R. v. Moore, 101 Miss. 768, 775, 58 So. 471, 473 (1912).

[91] *See, e.g.*, Illinois Cent. R.R. v. Ragan, 252 Miss. 335, 341, 173 So. 2d 433, 435 (1965); Avery v. Collins, 171 Miss. 636, 649, 157 So. 695, 698 (1934); Moore v. Johnson, 148 Miss. 827, 833, 114 So. 734, 735 (1927). *But see* Gordon v. Lee, 208 Miss. 21, 34, 43

ceased could have experienced any pain and suffering is apparently thought to be too speculative. But even the shortest moment of consciousness between injury and death can sufficiently support an award of damages for the deceased's pain and suffering.[92]

Assigning a pecuniary value to the deceased's pain and suffering is an issue for the trier of fact to resolve in its discretion.[93] The proper amount to be awarded depends on the facts of each particular case. Again, previous judicial decisions provide little guidance regarding the reasonableness of these recoveries, since it is usually impossible to ascertain that part of the total damage award representing compensation for the deceased's pain and suffering.[94]

D. Punitive Damages

Punitive damages are recoverable in a proper case under section 11-7-13 as compensation for injury to the decedent.[95] Such damages are a permissible element of the award only when evidence is presented at trial showing that the decedent's death was caused by willful, wanton, or grossly negligent conduct on the part of the defendant.[96] An

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So. 2d 665, 668 (1950) (decedent was found to have undergone a great deal of pain and suffering prior to death even though testimony was introduced tending to show that decedent remained unconscious from the time of injury until death).

[92] Boyd Constr. Co. v. Bilbro, 210 So. 2d 637, 640 (Miss. 1968). The decedent in *Boyd Constr. Co. v. Bilbro* was conscious only for a brief interval between injury and death. Evidence that she cried out was held sufficient to show that she experienced pain and suffering while conscious. Therefore, the jury, in its discretion, correctly established a monetary value as compensation for this pain and suffering. *Id.*

[93] *Id. See also* S.H. Kress Co. v. Markline, 117 Miss. 37, 61, 77 So. 858, 866 (1918) (suggesting that value to be put on pain and suffering of decedent is question left to jury under the wrongful death act).

[94] *See supra* note 87.

[95] Thornton v. Insurance Co. of North America, 287 So. 2d 262, 265 (Miss. 1973). *See also* Alabama & V. Ry. v. Kelly, 126 Miss. 276, 287, 88 So. 707, 709 (1921) (jury determines propriety of punitive damages award in each case).

[96] *See* Sheffield v. Sheffield, 405 So. 2d 1314, 1317 (1981) (gross negligence or willful and wanton misconduct required before award of punitive damages is proper); Young v. Columbus & G. Ry., 165 Miss. 287, 294, 147 So. 342, 343 (1933) (punitive damage award determined to be proper when willful or wanton injury occurred); Yazoo & M.V. R.R. v. Lee, 148 Miss. 809, 824, 114 So. 866, 870 (1928) (no punitive damages allowed where defendant's conduct does not amount to willfulness or wantonness); Alabama & V. Ry. v. Kelly, 126 Miss. 276, 286, 88 So. 707, 708 (1921) (gross negligence on part of defendant); Carrier Lumber & Mfg. Co. v. Boxley, 103 Miss. 489, 490, 60 So. 645, 645 (1913) (no evidence presented to support instruction that jury might award punitive damages); St. Louis & S.F. R.R. v. Moore, 101 Miss. 768, 774-75, 58 So. 471, 472-73 (1912) (punitive damages recoverable where defendant's conduct is willful, wanton, or grossly negligent).

award of either actual or nominal damages will support a recovery of punitive damages.[97] The propriety of an award of punitive damages is within the discretion of the trier of fact,[98] and the trier of fact is permitted wide latitude in determining the appropriate sum.[99]

III. Conclusion

Section 11-7-13 of the Mississippi Code is a relational statute limiting the persons entitled to recover damages for wrongful death to certain beneficiaries who occupy a close family status in relation to the deceased. Through interpretation by the Mississippi Supreme Court, the objective of compensating those named beneficiaries has been accomplished to a great degree. The only unfilled gap in possible compensation occurs when the deceased lives for a period of time between the injury and death.[100] In such a case the beneficiaries' loss of support, in the form of the present net cash value of the deceased's life expectancy, is taken into account beginning at the time of death, rather than the time when the injury occurred.[101] Perhaps the amount of support that is lost by the beneficiaries between injury and death is negligible in most cases, and, therefore has been intentionally ignored for administrative reasons.

To enhance judicial economy, beneficiaries named in section 11-7-13 should strongly consider allowing the personal representative of the deceased to bring one action in two counts for the benefit of both the survivors and the deceased's estate. The issues regarding allowable damages can then be disposed of in one suit rather than in two. Also, the use of special verdicts at the trial level[102] would greatly expedite the development of future guidelines for determining the adequacy or inadequacy of damage awards at the appellate level.

Janet G. Arnold

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[97] 165 Miss. at 295, 147 So. at 344.

[98] Alabama & V. Ry. Co. v. Kelly, 126 Miss. 276, 287, 88 So. 707, 709 (1921).

[99] *Id.*, 88 So. at 709.

[100] *See supra* text accompanying note 74 (discussion of failure of § 11-7-13 to provide for loss of support damages for time between decedent's injury and death).

[101] *Id.*

[102] *See* Miss. R. Civ. P. 49(b) (special verdicts). The special verdict is not new to Mississippi civil practice. *See, e.g.*, State v. Allen, 69 Miss. 508, 517-18, 10 So. 473, 475 (1891) (special verdict used). Over the years, however, use of the special verdict appears to have waned. *See* Miss. R. Civ. P. 49(b) comment.

RECENT DECISIONS

TORTS—PRODUCTS LIABILITY—BUILDER-VENDOR LIABLE TO SUBSEQUENT PURCHASER FOR DEFECTIVE CONSTRUCTION OF HOME

Plaintiff, a remote purchaser of a house,[1] filed suit in the Circuit Court of the First Judicial District of Hinds County against the defendant builder for damages[2] that allegedly resulted from negligence and breach of an implied warranty in construction of the house.[3] Plaintiff alleged that after moving into the house she discovered a latent defect.[4] The defendant's motion to dismiss for lack of privity between the parties was granted by the trial court.[5] On appeal, the Mississippi Supreme Court, *held*, reversed and remanded. A builder-vendor of a home may be held liable to a second or subsequent purchaser of a home for negligence or breach of an implied warranty. *Keyes v. Guy Bailey Homes, Inc.*, 439 So. 2d 670 (Miss. 1983).

The development of the doctrine of caveat emptor[6] in the English common law primarily occurred during the 17th and 18th centuries.[7] In

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[1] The court used the terms "remote purchaser" and "subsequent purchaser" interchangeably. Keyes v. Guy Bailey Homes, Inc., 439 So. 2d 670, 670-71 (Miss. 1983). The house first was sold to Troy Gerald Fulgram on August 7, 1975. Fulgram in turn sold the house to the plaintiff, Kathleen Keyes, on July 1, 1979. *Id.*

[2] Plaintiff sought damages in the amount of $100,000. *Id.* at 675 (Walker, J., dissenting).

[3] *Id.* at 670. Plaintiff alleged that the defendant breached an implied warranty of workmanship and habitability. *Id.* at 674 (Walker, J., dissenting).

[4] *Id.* The alleged defect was a cracked foundation. *Id.*

[5] *Id.* at 670. Existing Mississippi case law required privity of contract between the builder and the purchaser of a permanent structure on real estate as a prerequisite to the purchaser's cause of action. *Id.* at 671.

[6] "Let the buyer beware." BLACK'S LAW DICTIONARY 202 (5th ed. 1979).

[7] Bearman, *Caveat Emptor in Sales of Realty - Recent Assaults upon the Rule*, 14 VAND. L. REV. 541, 542 (1961). Primarily because of the influence of the church, which frowned upon profit-oriented commerce, caveat emptor was not a significant doctrine during the Middle Ages. Hamilton, *The Ancient Maxim Caveat Emptor*, 40 YALE L.J. 1133, 1136-41 (1931). In Babylonia, under the Code of Hammurabi, if a builder's negligent construction caused the death of the home owner's son, the builder's son was put to death. Witherspoon, *Architects' and Engineers' Tort Liability*, 16 DEF. L.J. 409, 409 (1967). *See also* Guilian, *Liability of Architects and Engineers*, 35 TENN. L. REV. 9, 9 (1967) (eye-for-an-eye doctrine enforced in ancient Babylon).

1603, the English judicial system first approved the doctrine in a case involving the sale of a worthless stone.[8] By the 1800's, caveat emptor was solidly entrenched in sales of both real and personal property in the United States.[9] By law, the purchaser of a completed home took responsibility for the risk of damage resulting from defective construction unless he had obtained express warranties to the contrary from the builder.[10]

Beginning with the 1842 English case of *Winterbottom v. Wright*,[11] the common law required privity of contract for an injured party to maintain an action against a contractor for defective construction.[12] After the *Winterbottom* decision, a number of exceptions devel-

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[8] Chandelor v. Lopus, 79 Eng. Rep. 3 (K.B. 1603). The court observed that any seller would naturally promote his wares and his knowledge that his representations were false was irrelevant unless an express warranty existed. *Id.* at 4. *Chandelor* "was destined to give the prestige of authority to the rising doctrine of caveat emptor." Hamilton, *supra* note 7, at 1166. According to Lord Coke, "by the civil law every man is bound to warrant the thing that he selleth or conveyeth, albeit there be no expresse warranty; but the common law bindeth him not, unless there be a warranty either in deed or in law; for *caveat emptor*. . . ." 1 E. COKE, COMMENTARY UPON LITTLETON § 145 at 102a (19th ed. 1853). According to Prosser, at that time the assumption seemed to be that every seller would lie. W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 4, at 19 (4th ed. 1971).

[9] Note, *Strict Liability in Tort for the Builder-Vendor for Property Damage Caused by Structural Defects*, 46 MISS. L.J. 510, 510-11 (1975). Caveat emptor usually did not affect buyers of new houses adversely, since the common practice was for the buyer to provide the contractor with both land and plans for construction of the house. Then the buyer would pay him in stages, as the house was completed to the architect's satisfaction. Roberts, *The Case of the Unwary Home Buyer: The Housing Merchant Did It*, 52 CORNELL L. Q. 835, 837 (1967).

The doctrine of caveat emptor was more readily accepted in America than it had been in England. Intellectual individualism, the frontier spirit, an emerging industrial system, and the ready acceptance of common law precedents contributed to the rise of caveat emptor to the level of doctrine in the United States. Hamilton, *supra* note 7, at 1186. In Barnard v. Kellogg, 77 U.S. (10 Wall.) 383, 388-89 (1870), the Supreme Court observed that all the common law states except South Carolina applied the doctrine.

[10] Roberts, *supra* note 9, at 836-37.

[11] 152 Eng. Rep. 402 (Ex. 1842).

[12] *Id.* at 403. In *Winterbottom v. Wright*, a driver of a mail coach sustained injuries when a wheel broke and threw him from his seat. The court did not allow the driver to maintain a cause of action against the contractors responsible for maintaining the mail coach because he was not in privity with them. *Id.* at 403. The court used privity to draw the line of liability, fearing, in Chief Baron Abinger's words, "an infinity of actions" if it held otherwise. *Id.* at 404. Baron Rolfe thought that the absence of a remedy for an innocent third party should not influence the court. "Hard cases, it has been frequently observed, are apt to introduce bad law." *Id.* at 406. According to Prosser, *Winterbottom* "has been described as a fishbone in the throat of the law." W. PROSSER, *supra* note 8, § 96, at 641.

oped that provided relief to injured third parties.[13] A 1916 New York case, *MacPherson v. Buick Motor Co.*,[14] became the leading case that abandoned the privity requirement in the field of products liability.[15] The court found that a duty of careful construction existed even in the absence of privity if the product was such that its negligent construction would make personal injury foreseeable.[16] The basis of liability in *MacPherson* was in tort, not contract.[17] Liability for foreseeable harm resulting from negligent construction was imputed to the defendant, Buick Motor Company, because it introduced the product into the open market.[18]

By analogy, *MacPherson* came to influence the liability of builders for defective construction and provided a means by which an injured party could maintain an action against the builder for his negligent work.[19] In the 1923 case of *Mincy v. Crisler*,[20] the Mississippi Supreme Court first applied tort rather than contract theory to a case involving

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[13] The most significant exception was that of articles inherently or imminently dangerous to personal safety. W. PROSSER, *supra* note 8, § 96, at 642. This exception first was recognized in a case involving a falsely labeled poison. *See* Thomas v. Winchester, 6 N.Y. 397 (1852). Exceptions also developed in the area of builders' liability. *See, e.g.*, Pennsylvania Steel Co. v. Elmore & Hamilton Contracting Co., 175 F. 176, 179 (N.D.N.Y. 1909) (contractor liable when he knew work was dangerously defective); Holland Furnace Co. v. Nauracaj, 105 Ind. App. 574, 14 N.E.2d 339, 342-43 (1938) (product of work was inherently or imminently dangerous); Grodstein v. McGivern, 303 Pa. 555, 154 A. 794, 795 (1931) (use by third party was intended or foreseeable by the builder).

[14] 217 N.Y. 382, 111 N.E. 1050 (1916).

[15] *See* Note, *supra* note 10, at 512 n.13 (*MacPherson* doctrine readily extended). The case involved the construction of a defective automobile. 217 N.Y. 382, 111 N.E. at 1051. By 1956, every state except Mississippi had adopted the *MacPherson* doctrine. W. PROSSER, *supra* note 10, § 96, at 643. Faced with similar facts twelve years after *MacPherson*, the Mississippi Supreme Court ruled that privity of contract was required for a consumer to maintain an action against a manufacturer. *See* Ford Motor Co. v. Myers, 151 Miss. 73, 77-78, 117 So. 362, 363 (1928) (allegedly defective truck caused remote vendee's death).

[16] *MacPherson*, 111 N.E. at 1053.

[17] *Id.* at 1051. In Judge Cardozo's words, "we have put aside the notion that the duty to safeguard life and limb, when the consequences of negligence may be foreseen, grows out of contract and nothing else." *Id.* at 1053.

[18] *Id.* at 1055. *See generally* W. PROSSER, *supra* note 8, § 96.

[19] W. PROSSER, *supra* note 8, § 104, at 681. *MacPherson* was not generally extended to realty until after 1945. Bearman, *supra* note 7, at 567; *see, e.g.*, Pastorelli v. Associated Eng'rs, Inc., 176 F. Supp. 159, 163 (D.R.I. 1959) (builder-vendor liable in tort for injuries sustained by purchaser's employee caused by structural defects in heating system); Dow v. Holly Mfg. Co., 49 Cal. 2d 720, 321 P.2d 736, 738 (1958) (contractor liable in tort to widow for deaths of subsequent purchaser and children from carbon monoxide that escaped from defective heater). *See infra* note 46.

[20] 132 Miss. 223, 96 So. 162 (1923).

faulty home construction.[21] The court held that when a builder-vendor knew of a latent defect that would cause damage to the house at some future time, he was under a duty to disclose it to the purchaser.[22] Using reasoning similar to that applied in implied warranty cases,[23] the court determined that an initial purchaser had a "right to presume"[24] that "no reasonably prudent man" would construct a house in that manner.[25] The doctrine of caveat emptor was conspicuously absent from the court's opinion.[26]

During the mid-1930's, the prevailing American rule required that a vendor have actual knowledge of a latent defect at the time of sale before liability was imposed, thus generally precluding implied warranties, but leaving the parties free to agree on express warranties.[27] In 1933, the Mississippi Supreme Court ruled that caveat emptor still ap-

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[21] *Id.* at 237, 96 So. at 163. Crisler constructed the house over a ditch that he had covered with old and decaying lumber. The covering gave way causing damage to the foundation and other parts of the house. The court held that "no reasonably prudent man" would construct a foundation over a six-foot ditch. *Id.* at 236-37, 96 So. at 162-63.

[22] *Id.* at 237-38, 96 So. at 163.

[23] *Mincy* has occasionally been interpreted as imposing an implied warranty. *E.g.*, Oliver v. City Builders, 303 So. 2d 466, 469 (Miss. 1974) (Inzer, J., specially concurring). Most common law jurisdictions steadfastly refused to find implied warranties in the sales of homes. Bearman, *supra* note 7, at 543. *See infra* note 27 (durability of caveat emptor in real estate context).

[24] 132 Miss. at 238, 96 So. at 163.

[25] *Id.* at 238, 96 So. at 163.

[26] In *Mincy*, the builder-vendor knew that the covered ditch turned unexpectedly, was running underneath the house, and that foundation pillars were placed over it. The buyer was not aware of the course of the ditch and could not be charged with such knowledge even though he had inspected the premises. *Id.* at 235-38, 96 So. at 162-63. *Cf.* Corley v. Reed, 164 Miss. 678, 690, 145 So. 241, 243 (1933) (applying equity theory to buyer's reliance on vendor's representation about quantity of cultivated land).

[27] According to Williston, caveat emptor was "still in full force" and "there can be no warranty of quality or condition implied in the sale of real estate." 4 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 926, at 2602-03 (rev. ed. S. Williston & G. Thompson 1936). According to the *Restatement*, the vendor should not be held liable for bodily harm unless he concealed or failed to disclose to the vendee a condition posing an unreasonable risk. The *Restatement* required that the vendee be unaware of the condition, and that the vendor have reason to believe the vendee would not discover it. RESTATEMENT OF TORTS §§ 352, 353 (1934).

The occasional harsh results of the rule were illustrated by a Tennessee case decided the same year as *Mincy*, in which a mother saw her 2-½ year old son crushed to death when a negligently constructed brick and concrete mantel fell on him as he reached for a picture of his father. The mother's foot also was trapped in the rubble as she attempted to rescue her son. The court held that constructive knowledge of the defect imposed no duty to warn, stating that "the rule of caveat emptor generally applies to sales of land." Smith v. Tucker, 151 Tenn. 347, 270 S.W. 66, 69 (1925).

plied to cases involving the sale of real estate with patent defects.[28] The court reasoned that when a knowledgeable purchaser inspected real estate containing patent defects discoverable through the exercise of ordinary care, caveat emptor operated to deny him a cause of action based on such defects.[29]

Traditionally, the concept of merger prevented the implication of warranties in the sale of real estate.[30] In *Miller v. Cannon Hill Estates, Ltd.*,[31] the King's Bench introduced an exception to the doctrine of caveat emptor by finding that an implied warranty of workmanship and habitability existed between the builder-vendor and his vendee,[32] even though the parties had contracted for sale prior to completion of a new home.[33] The court found that this implied warranty existed independently of any express agreement of the parties.[34]

In the United States, primarily because of the influence of the Uniform Sales Act and the Uniform Commercial Code, the doctrine of caveat emptor all but disappeared from the law of chattels.[35] No similar changes, however, occurred in the rules governing realty until after World War II.[36] In the post-1945 period, a burgeoning demand for homes inspired an increasing number of builder-vendors to utilize mass-production techniques in housing developments.[37] Hurried construction by builders and hasty inspections by inexperienced buyers contributed to an increase in instances of purchaser dissatisfaction.[38]

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[28] Corley v. Reed, 164 Miss. 678, 689, 145 So. 241, 243 (1933). *Corley* involved the sale of farm land. The alleged defect was that the property did not contain as much cultivated land as the seller had represented. *Id.* at 685-86, 145 So. at 241-42.

[29] *Id.* at 689-90, 145 So. at 243. *See also* Hall v. Thompson, 5 Miss. (1 S. & M.) 443, 482 (1843) (purchaser of land denied relief for patent defects discoverable by "ordinary vigilance").

[30] *See* 3 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 723, at 2058-59 (rev. ed. S. Williston & G. Thompson 1936) (terms of contract for sale of land merged into deed, purchaser thus had no rights except those provided in deed, absent fraud or mistake).

[31] [1931] 2 K.B. 113.

[32] Bearman, *supra* note 7, at 543-44.

[33] [1931] 2 K.B. at 120. *See also* Lawrence v. Cassel, [1930] 2 K.B. 83, 90 (builder has implied duty to construct house in an efficient and workmanlike manner using proper materials).

[34] *Miller*, [1930] 2 K.B. at 122.

[35] Bearman, *supra* note 9, at 542. In 1953, Pennsylvania became the first state to adopt the Uniform Commercial Code. PA. STAT. ANN. tit. 12A, § 1-101 (Purdon 1970). Mississippi adopted the Code in 1966. *See* MISS. CODE ANN. § 75-1-101 (1972).

[36] Bearman, *supra* note 7, at 542-43. *See infra* note 40.

[37] Bearman, *supra* note 7, at 542.

[38] *Id.*; *cf.* Caporaletti v. A-F Corp., 137 F. Supp. 14, 15 (D.D.C. 1956) (purchaser

Still under the influence of caveat emptor, the courts were reluctant to permit recovery.[39]

In the late 1950's, however, states began to adopt the *Miller* rule,[40] and in the 1964 case of *Carpenter v. Donohoe*, Colorado extended the implied warranty concept to purchasers of new homes entering into a sales contract after completion of the house.[41] As the New Jersey Supreme Court noted in *Schipper v. Levitt & Sons, Inc.*,[42] builders and purchasers of mass-produced homes did not deal on the equal footing necessary for application of the doctrine of caveat emptor.[43]

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injured by defectively fastened stairway in one of several hundred homes in builder-vendor's suburban development); Schipper v. Levitt & Sons, Inc., 44 N.J. 70, 207 A.2d 314, 316-17 (1965) (child of purchaser's lessee scalded by excessively hot water from bathroom faucet in mass development home).

[39] *See, e.g.*, Berger v. Burkoff, 200 Md. 561, 92 A.2d 376, 379 (1952) (caveat emptor barred liability of builder-vendor for water flowing into basement, despite oral representations of waterproof condition); Evens v. Young, 196 Tenn. 118, 264 S.W.2d 577, 580-81 (1954) (caveat emptor barred liability of builder-vendor for fire damage caused by water heater explosion). The disparity between the protection given a purchaser of chattels and that given a purchaser of real estate meant that one who spent fifty dollars on a new chair would be better protected than one who spent his life's savings on a new home. *See* Wawak v. Stewart, 247 Ark. 1093, 449 S.W.2d 922, 923 (1970) (hypothetically, purchaser of non-merchantable kitchen mop would be entitled to refund while a purchaser of $50,000 home that collapsed due to defective foundation would be without remedy).

[40] *See, e.g.*, Glisan v. Smolenske, 153 Colo. 274, 387 P.2d 260, 263 (1963) (delivery of deed did not preclude implied warranty of habitability under sales contract signed prior to home's completion); Weck v. A:M Sunrise Constr. Co., 36 Ill. App. 2d 383, 184 N.E.2d 728, 734 (1962) (all terms of contract of sale not necessarily merged by delivery of deed); Hoye v. Century Builders, 52 Wash. 2d 830, 329 P.2d 474, 476 (1958) (implied warranty existed when builder represented himself as experienced, furnished house plans, entered into contract prior to house's completion). *But see* Coutrakon v. Adams, 39 Ill. App. 2d 290, 188 N.E.2d 780, 785-86 (1963) (builder-vendor not liable for fire damage caused by negligently installed furnace).

[41] 154 Colo. 78, 388 P.2d 399, 402 (1964). Previously, only a dissenting opinion in 1957 had attempted to extend the *Miller* rule to purchasers contracting after construction was completed. *See* Levy v. Young Constr. Co., 46 N.J. Super. 293, 134 A.2d 717, 720 (1957) (Waeshe, J., dissenting).

[42] 44 N.J. 70, 207 A.2d 314 (1965).

[43] 207 A.2d at 326. The court noted the need for keeping the common law principles in line with current concepts of justice and insisted that ancient distinctions that make no sense in today's society should be readily rejected. It also reasoned that the burden of loss resulting from improper construction should be borne by the developer, who created the danger and who was in a better financial position to bear the loss, rather than the injured person who relied on the developer's expertise and implied representation. *Id.* at 325-26; *see also* Bethlahmy v. Bechtel, 91 Idaho 55, 415 P.2d 698, 710 (1966) (application of caveat emptor to inexperienced home buyer in favor of experienced builder was unjust). A number of courts concluded that no meaningful distinction could be made between a builder engaged in mass production of homes and a manufacturer engaged in

In home sales, the adoption of the *MacPherson* rule eliminating the need to prove privity to establish liability[44] was, like the spread of the *Miller* rule, primarily a post-1945 phenomenon.[45] The landmark products liability cases of the early 1960's providing for the strict liability of manufacturers,[46] paved the way for the application of strict liability and the relaxation of the privity requirement in the field of construction.[47] Although in 1964 the Mississippi Supreme Court declared that the doctrine of caveat emptor still applied to a contract for the sale of property,[48] the court reached an incongruous result two years later in *State Stove Manufacturing Co. v. Hodges*.[49] The court found that a builder who had installed a defective water heater in a

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mass production of chattels. *See, e.g.*, Kriegler v. Eichler Homes, Inc., 269 Cal. App. 2d 224, 74 Cal. Rptr. 749 (1969) (strict liability applied). *Compare Schipper*, 207 A.2d at 325-26 (rejecting caveat emptor for homes built through mass production) *with* Rutledge v. Dodenhoff, 254 S.C. 407, 175 S.E.2d 792, 795 (1970) (rejecting caveat emptor without regard to method of construction).

[44] *See, e.g.*, Holland Furnace Co. v. Nauracaj, 105 Ind. App. 574, 14 N.E.2d 339, 342-45 (1938) (negligence action not demurrable on basis of lack of privity between parties since company owed duty to properly install furnace).

[45] Bearman, *supra* note 7, at 567. *See, e.g.*, Carter v. Livesay Window Co., 73 So. 2d 411, 413 (Fla. 1954) (*MacPherson* applicable when child killed during construction phase).

[46] *See, e.g.*, Greenman v. Yuba Power Prods., Inc., 59 Cal. 2d 57, 377 P.2d 897, 901, 27 Cal. Rptr. 697, 701 (1962) (manufacturer strictly liable, without regard to warranty, for injuries caused by defective power tool).

[47] *See, e.g.*, Kriegler v. Eichler Homes, Inc., 269 Cal. App. 2d 224, 74 Cal. Rptr. 749, (1969) (no meaningful distinction between mass producer of homes and mass manufacturer of chattels); State Stove Mfg. Co. v. Hodges, 189 So. 2d 113, 123 (Miss. 1966) (contractor subject to strict liability for installation of defective product in home), *cert. denied*, 386 U.S. 912 (1967); Schipper v. Levitt & Sons, Inc., 44 N.J. 70, 207 A.2d 314, 325 (1965) (builder-vendor of mass produced homes strictly liable for defective design). The major break in the extension of implied warranties beyond food and drink for human consumption in the absence of privity or negligence came in a building construction case, Spence v. Three Rivers Builders & Masonry Supply, Inc., 353 Mich. 120, 90 N.W.2d 873, 878 (1958). W. PROSSER, *supra* note 10, § 97, at 654.

[48] Koch v. H & S Dev. Co., 249 Miss. 590, 629, 163 So. 2d 710, 727 (1964). The case involved a dispute over the interpretation of a lease, and the court held that the parties to an agreement for the sale or lease of property had a right to contract as they desired, provided that the agreement was not illegal or against public policy. Consequently, the parties were entitled to rely upon the mutually accepted terms. The court thought the written words of the contract provided a clearer indication of the parties' intentions and closer compliance with the agreed performance than did "retrospective, impassive conclusions" of an equity court. *Id.* at 629-30, 163 So. 2d at 727.

[49] 189 So. 2d 113 (Miss. 1966), *cert. denied*, 386 U.S. 912 (1967). For a thorough discussion of the doctrine of strict liability adopted in *State Stove*, see Note, *Strict Liability of a Manufacturer to a Consumer*, 38 MISS. L.J. 341, 342-43 (1967).

new home was strictly liable to the owners for damages suffered when the water heater exploded and substantially destroyed the house and its contents.[50] The court further found that privity of contract was not necessary in a suit by a consumer against a manufacturer.[51] The court adopted the RESTATEMENT (SECOND) OF TORTS standard of strict liability[52] insofar as it applied to a manufacturer of a product and to a contractor who built and sold a house with the product in it.[53] The imposition of strict liability did not preclude liability based upon negligence.[54] The court was not impressed with the implied warranty concept as a remedy, observing that to make such a warranty run with the product unnecessarily complicated the issue of a manufacturer's liability. The court stated that since the privity requirement was abolished, the liability was in tort, not contract, and the concept of warranty was held "irrelevant."[55]

The extension of homebuilders' liability accomplished in *State*

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[50] 189 So. 2d at 123-24. The earliest Mississippi case of a consumer recovering against a manufacturer under a theory resembling strict liability was Jackson Coca-Cola Bottling Co. v. Chapman, 106 Miss. 864, 64 So. 791 (1914), in which a bottler was held liable for damages resulting from a consumer finding a mouse in his soft drink. The theory behind holding the bottler liable is uncertain because the court used language suggesting both negligence and strict liability. *See id.* at 869, 64 So. at 791. The next major Mississippi case in the development of strict liability was Coca-Cola Bottling Works v. Lyons, 145 Miss. 876, 885, 111 So. 305, 307 (1927). *Lyons* was the first case in any jurisdiction to find a warranty running with the product from the manufacturer to the ultimate consumer. W. PROSSER, *supra* note 8, § 97, at 654. By the 1960's, many courts were imposing liability without privity under some theory of warranty. Prosser, *The Assault Upon the Citadel (Strict Liability to the Consumer)*, 69 YALE L. J. 1099, 1106 (1960). The *Schipper* court, for example, mixed concepts of warranty with strict liability, but still concluded that the requirement of privity had no further place in the liability of builders to injured occupants. *See* 207 A.2d at 328. The reasoning of the *Lyons* warranty decision was considered and rejected by the California Supreme Court in Greenman v. Yuba Power Prods., Inc., 59 Cal. 2d 57, 377 P.2d 897, 901, 27 Cal. Rptr. 697, 701 (1962).

[51] 189 So. 2d at 116; *cf.* Triplett v. American Creosote Works, 251 Miss. 727, 733, 171 So. 2d 342, 345 (1965) (privity unnecessary if injury is due to condition of product foreseeable at time of sale); Cox v. Laws, 244 Miss. 696, 702, 145 So. 2d 703, 706 (1962) (dangerous product one of many exceptions to privity requirement).

[52] 189 So. 2d at 118. The liability imposed covered physical injury "to the ultimate user or consumer, or to his property." RESTATEMENT (SECOND) OF TORTS § 402A (1965).

[53] 189 So. 2d at 118. The court found that the water heater was not defective or unreasonably dangerous as manufactured and held for the manufacturer, State Stove. The contractors were held liable for failing to install a pressure and temperature relief valve. *Id.* at 123.

[54] *Id.* at 118.

[55] *Id.* at 119. Thus, the court by adopting strict liability jumped over both the *MacPherson* and *Miller* rules. W. PROSSER, *supra* note 10, § 96 n.23.

Stove was limited to first purchasers in *Oliver v. City Builders, Inc.*[56] Relying on the contract principles of caveat emptor and merger, the Mississippi Supreme Court held that the rules of strict liability and implied warranty did not apply as between a remote purchaser and the builder of a home.[57] Not only were there no implied warranties running to remote purchasers, there were no implied warranties as to *any* purchasers.[58] Justice Inzer, in a special concurrence, agreed with the court's decision only to the extent that it denied recovery to a remote purchaser.[59] He disapproved of the invocation of caveat emptor and merger to deny the liability of a builder-vendor to the first purchaser in cases involving latent defects of a new house,[60] and insisted that an implied warranty of workmanship and habitability should exist between a builder-vendor and the purchasers of a new home.[61] Reasoning that under modern conditions the buyer and the builder-vendor did not deal at arm's length, Justice Inzer concluded that caveat emptor did not apply to latent defects.[62] He further argued that since an implied warranty arose by operation of law, it could not be eliminated by the mere passing of title through a deed.[63] Thus, he concluded that the merger rule did not prohibit an implied warranty between the builder-vendor and the first purchaser.[64] Justice Robertson, in a dissenting opinion, strenuously argued that caveat emptor and the requirement of privity had been abolished by the court's previous decisions in *Mincy* and *State Stove*.[65] The dissent regarded a finished home as a product[66]

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[56] 303 So. 2d 466, 469 (Miss. 1974). *Oliver* is discussed at length in Note, *Strict Liablity in Tort for the Builder-Vendor for Property Damage Caused by Structural Defects*, 46 Miss. L.J. 510 (1975).

[57] 303 So. 2d at 469. The court revived the traditional rationale of merger that a buyer may insist upon inclusion of any desired warranties in the deed. *Id.*

[58] *Id. Contra* Cochran v. Keeton, 287 Ala. 439, 252 So. 2d 313, 314 (1971) (implied warranty applied to sale of new house by builder-vendor); Wawak v. Stewart, 247 Ark. 1093, 449 S.W.2d 922, 923 (1970) (implied warranty existed in sale of new house to first purchaser).

[59] 303 So. 2d at 469 (Inzer, J., specially concurring). Four other justices joined in the concurrence. *Id.* at 470.

[60] Citing *Mincy*, Justice Inzer argued that "[i]t has long been the rule in this state that a builder-vendor of a new home is liable to his vendee for latent defects." 303 So. 2d at 469 (Inzer, J., specially concurring).

[61] *Id.* at 470.

[62] *Id.* at 469.

[63] *Id.* at 469-70.

[64] *Id.*

[65] *Id.* (Robertson, J., dissenting). Chief Justice Gillespie and Justice Sugg joined in the dissent. *Id.* at 473.

[66] *Id.* at 472. Other courts have also viewed a finished home as a product. *See, e.g.,*

and would have applied negligence or strict liability principles in an action by a remote purchaser against a builder-vendor.[67]

In 1978 the Mississippi Supreme Court in *Brown v. Elton Chalk, Inc.*,[68] held that an implied warranty of workmanship and habitability did exist between the builder-vendor of a new home and the first purchaser of the home. This implied warranty, however, was not extended to subsequent purchasers.[69] Two years later, in *Hicks v. Greenville Lumber Co., Inc.*,[70] the court specifically declined to extend *Brown* to remote purchasers.[71] The *Hicks* court, without further explanation, repeated Justice Inzer's concurrence in *Oliver* and the rule adopted in *Brown*.[72]

Dow v. Holly Mfg. Co., 49 Cal. 2d 720, 321 P.2d 736, 739 (1958) (builder vouches for each part of completed home just as manufacturer of chattels vouches for component parts of his product); *see also* Barnes v. Mac Brown & Co., Inc., 264 Ind. 227, 342 N.E.2d 619, 620 (1976) (logic of products liability equally persuasive in real property context).

[67] 303 So. 2d at 471 (Robertson, J., dissenting).

[68] 358 So. 2d 721, 722 (Miss. 1978). *See* Comment, *In Search of a Habitable Home in Mississippi*, 49 MISS. L.J. 881, 905 (1978) (*Brown* marked retreat from caveat emptor). The *Brown* court heavily relied upon Justice Inzer's concurring opinion in *Oliver*. 358 So. 2d at 722.

[69] 358 So. 2d at 722. The court held that "a party bringing suit based upon such an implied warranty must allege in his declaration, *inter alia*, that (1) the house is new; and (2) that the plaintiff was the first purchaser." *Id. See also Oliver*, 303 So. 2d at 470 (Inzer, J., specially concurring) (implied warranty of workmanship and habitability should not extend to subsequent purchasers). The *Brown* court did not cite or discuss any cases from other jurisdictions supporting its decision. For a discussion of recent cases pertaining to the liability of home builders to subsequent purchasers, see Annot., 10 A.L.R. 4TH 385 (1981).

[70] 387 So. 2d 94 (Miss. 1980).

[71] *Id.* at 96.

[72] *Id.* As in *Brown*, the court did not cite or discuss cases from other jurisdictions to support its ruling. 387 So. 2d 94. Other jurisdictions had extended implied warranties to subsequent purchasers. *See, e.g.*, Barnes v. Mac Brown & Co., Inc., 264 Ind. 227, 342 N.E.2d 619, 620 (1976) (builders' implied warranties of fitness and habitability extend to subsequent purchasers); Wagner Constr. Co., Inc. v. Noonan, 403 N.E.2d 1144, 1146-48 (Ind. App. 1980) (implied warranties of fitness and habitability continue for reasonable time and extend to subsequent purchasers); Terlinde v. Neely, 245 S.C. 395, 271 S.E.2d 768, 770 (1980) (implied warranties extend for reasonable time to subsequent purchasers as members of the class for which home was constructed); Moxley v. Laramie Builders, Inc., 600 P.2d 733, 735-36 (Wyo. 1979) (builder may be held liable to subsequent purchaser under negligence or implied warranty). At least one jurisdiction had ruled that a subsequent purchaser was entitled to an action against a builder based on negligence but not on implied warranty. *See* Coburn v. Lenox Homes, Inc., 173 Conn. 567, 378 A.2d 599, 602 (1977). Subsequent purchasers of townhouses have been allowed to join a class action against the builder. *See* Newman v. Tualatin Dev. Co., Inc., 287 Or. 47, 597 P.2d 800, 802 (1979).

In other cases, however, courts have refused to extend liability to subsequent pur-

In the instant case, the court reasoned that because the purchase of a home is a major financial investment[73] that is generally made by a purchaser who lacks the requisite knowledge or expertise to discover many construction defects, the purchaser is forced to rely upon the builder's honesty and expertise.[74] The court found that most purchasers have no practical means of protecting themselves against major financial catastrophe resulting from faulty construction of a house, therefore a legal theory must be designed to protect innocent purchasers.[75] Moreover, since the law provides a remedy for the injured first purchaser, no reasonable justification exists for distinguishing between innocent first and innocent subsequent purchasers. The law, therefore, ought to provide a remedy for innocent subsequent purchasers who suffer a loss through some fault of the builder.[76] The court acknowledged that it was broadening the class of persons permitted to maintain a suit, and the potential for unfair surprise and injustice to the building industry existed.[77] It observed, however, that under an implied warranty the builder already owed a duty to construct a home in a workmanlike manner suitable for habitation. Furthermore, negligence principles required him to use reasonable care in building the house. The builder's burden would be no greater if his potential liability extended to remote purchasers.[78] Finally, the court noted that the

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chasers. *See, e.g.*, P.B.R. Enters., Inc. v. Perren, 243 Ga. 280, 253 S.E.2d 765, 767 (1979) (caveat emptor applies in sales of realty with no implied warranties pertaining to physical condition of property); Crowder v. Vandendeale, 564 S.W.2d 879, 881 (Mo. 1978) (builder's liability based in contract, not tort; therefore, privity requirement barred subsequent purchaser's action against builder).

[73] The court observed that the purchase of a home was often the most important and expensive investment made by a family. *Keyes v. Guy Bailey Homes, Inc.*, 439 So. 2d at 671.

[74] *Id.*

[75] *Id.* at 672.

[76] *Id.* The court detected a major trend in other jurisdictions, which extended protection to subsequent purchasers. *Id.*

[77] *Id.*

[78] *Id.* at 673. The court distinguished between a new primary rule and a remedial rule. An example provided by the court of a new primary rule was the overruling of prior case law granting tort immunity to state and administrative agencies. Such a change could have resulted in unfair surprise, since state and municipal agencies would be held to a new standard of reasonable care in the performance of their duties. *Id.* at 672. *See, e.g.*, Pruett v. City of Rosedale, 421 So. 2d 1046, 1052 (Miss. 1982) (example cited in *Keyes*). On the other hand, allowing punitive damages to be awarded in chancery courts, though a departure from the established practice, did not alter the basic rules of liability. This change thus was deemed a remedial rule. 439 So. 2d at 672-73 (citing Tideway Oil Programs, Inc. v. Serio, 431 So. 2d 454, 459 (Miss. 1983)). The court further reasoned that since the instant decision placed no higher duty or greater burden upon the building

legislature had already confronted the privity requirement by enacting a statute that plainly indicated an intention "to remove the privity requirement in all cases,"[79] and concluded that courts could, and should, choose to do likewise.[80]

In a dissenting opinion, Justice Walker expressed the fear that the rights of the home-building industry in Mississippi would be adversely affected by abolition of the privity requirement.[81] Additionally, according to Justice Walker, since the briefs before the court failed to provide an adequate basis for decision,[82] the instant case did not furnish the proper occasion for such a sweeping change. He stated that at the very least, the court should have limited its holding to the instant defendant and not upset prior case law.[83] The dissent stressed the reliance of homebuilders on prior case law in protecting themselves against potential liability, and argued that the change in the rule exposed them to additional liability against which they had no protection.[84]

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industry, the new rule would not be applied prospectively only, but would take effect as of the time of decision. 439 So. 2d at 673.

[79] 439 So. 2d at 673. The statute, enacted in 1976, states that "in all causes of action for personal injury or property damage or economic loss brought on account of negligence, strict liability or breach of warranty . . . privity shall not be a requirement to maintain said action." MISS. CODE ANN. § 11-7-20 (Supp. 1983). The builder's exposure extends for "ten years after the written acceptance or actual occupancy or use, whichever occurs first, of such improvement by the owner thereof." *Id.* § 15-1-41. The Mississippi Supreme Court has held that section 15-1-41 does not violate the state constitution's guarantee of access to the courts, and is not an unconstitutional special or local law. Anderson v. Fred Wagner and Roy Anderson, Jr., Inc., 402 So. 2d 320, 322-24 (Miss. 1981). Other jurisdictions have examined the constitutionality of such statutes with mixed results. *See, e.g.*, Joseph v. Burns, 260 Or. 493, 491 P.2d 203, 207-08 (1971) (correct exercise of legislative function to weigh likelihood barring valid claims against need to have definite time limit for potential liability). *But see, e.g.*, Phillips v. ABC Builders, Inc., 611 P.2d 821, 831 (Wyo. 1980) (similiar statutory provision not statute of limitations but rather grant of immunity from suit and therefore void). *See generally* Sisson and Kelley, *Statutes of Limitations for the Design and Building Professions - Will They Survive Constitutional Attack?*, 49 INS. COUNSEL J. 243 (1982); *Implied Warranties of Habitability - Recent Developments*, 29 DEF. L.J. 505 (1980).

[80] 439 So. 2d at 673.

[81] *Id.* at 674 (Walker, J., dissenting).

[82] *Id.* Defendant did not even file a brief, nor were amicus curiae briefs filed by the homebuilding industry. Justice Walker was not impressed with plaintiff's brief, which cited only three recent cases (*Hicks*, *Brown*, and *Oliver*) and one statute, MISS. CODE ANN. § 11-7-20 (Supp. 1982), and contained the argument that " '[t]he rule limiting the remedy to the first purchaser of the house is extremely unfair to a second purchaser of the house that happens to discover the latent defect.' " 439 So. 2d at 674-75 (Walker, J., dissenting).

[83] 439 So. 2d at 674 (Walker, J., dissenting).

[84] *Id.* (Walker, J., dissenting). The dissent also argued that because the plaintiff's

In addition to holding that remote purchasers of homes are entitled to maintain suits against the homebuilder based upon negligence or implied warranty principles, *Keyes* clearly suggests that such a suit may also be maintained in strict liability.[85] A remote purchaser may obtain recovery for personal injury or property damage.[86] Even though, under *Keyes*, all of a home's purchasers within the ten year limitation period are treated as members of the class entitled to sue, the court has not given the purchasers *carte blanche* to pick the homebuilder's pocket. Problems of proof remain, and the passage of time and the possibility of intervening causes may pose formidable obstacles to recovery.[87]

Keyes expands the builder's potential liability in that the ten year limitations period may no longer be effectively shortened by sale to a subsequent purchaser.[88] Builders understandably will want to protect themselves against this new exposure. The most effective means of doing so is, of course, to avoid the creation of dangerous conditions. One must presume that reputable builders have not been banking on a gratuitous shortening of their period of exposure through sale of the home to a subsequent purchaser. Their building practices should not be significantly affected. Nevertheless, the court has clearly given an additional incentive to use sound construction methods. Builders who cut corners and engage in shoddy construction practices will have more compelling reasons to convert to more reputable methods. Because of the added exposure, builders' insurance premiums can be expected to increase. As a result of higher construction costs stemming from new construction techniques or higher insurance premiums, the price of

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complaint did not clearly allege that the home was not suitable for habitation, or specify how the defendant was negligent in its construction or how the plaintiff was damaged, the complaint did not state a cause of action and was properly dismissed by the trial court. *Id.* at 675 (Walker, J., dissenting).

[85] *Keyes* abolished the privity requirement in all cases, including strict liability. *Id.* at 673. *See also* MISS. CODE ANN. § 11-7-20 (Supp. 1983) (legislative abolition of privity requirement). Under *State Stove*, Section 402A of the RESTATEMENT (SECOND) OF TORTS applies to builders. 189 So. 2d at 118. *See supra* notes 54, 64, 65 and accompanying text.

[86] *Keyes* involved property damage. 439 So. 2d at 670. *See also State Stove*, 189 So. 2d at 118 (destruction of home).

[87] One must remember that the burden of proof, at least initially, is on the plaintiff. Potential problems with the passage of time include the unavailability of evidence and, possibly, the absence of defendants.

[88] Although the basic standards of liability are unchanged, the number of purchasers entitled to maintain a cause of action has been increased. Builders are vulnerable to a larger number of potential litigants. Again, whether the subsequent purchaser can satisfy the burden of proof is another matter.

new homes can be expected to rise, although perhaps not by a significant amount. In turn, the increased cost of new homes will affect the market for used homes. A slight increase in the purchase price of homes will be the consumer's trade-off for the acquisition of a new right to recovery.

Leslie A. Kelley

Securities Regulation—Rule 10b-5—Duty of Tippee to Disclose Information or Abstain from Trading Arises Only When Information Source Owes Shareholders a Fiduciary Duty

After an administrative hearing, the Securities and Exchange Commission (SEC)[1] censured Dirks[2] for violation of antifraud provisions of the federal securities laws including SEC rule 10b-5.[3] The SEC found that Dirks had knowingly obtained confidential, material information from a corporate insider[4] and, thereby, owed the same fiduciary

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[1] The Securities and Exchange Commission was the respondent before the Supreme Court. Dirks v. SEC, 103 S. Ct. 3255, 3255 (1983).

[2] Dirks, petitioner before the Supreme Court, was an officer of a New York broker-dealer firm that specialized in providing institutional investors with investment analysis of insurance company securities. *Id.* at 3259-60.

[3] 103 S. Ct. at 3259. Rule 10b-5 provides that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
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> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1983).

[4] 103 S. Ct. at 3259. A former officer of Equity Funding of America informed petitioner Dirks that the assets of Equity Funding were vastly overstated because of fraudulent corporate practices. *Id.* at 3258. The source encouraged Dirks to verify the fraud and disclose it to the public. Dirks visited Equity Funding's headquarters where senior management denied the charges, but several employees corroborated the accusations of fraud. Dirks shared the information with several clients and investors, some of whom sold their Equity Funding securities (including five investment advisors who liquidated more than $16,000,000 in holdings). Dirks also urged the *Wall Street Journal* Los Angeles bureau chief to write a story on the fraud charges, but the paper declined. *Id.*

During the next two weeks, the price of Equity Funding stock fell dramatically and the New York Stock Exchange halted trading. *Id.* Not long afterwards Equity Funding's records were impounded by California insurance authorities and evidence of the fraud was uncovered. *Id.* at 3259. The Securities and Exchange Commission then filed its complaint against Equity Funding, and the *Wall Street Journal* published a front-page story on the fraud, based to a large extent on information gathered by Dirks. Equity Funding went into receivership. *Id.*

Because of his central role in exposing the fraud, Dirks was only censured by the SEC. *Id.* at 3259-60. The SEC has authority to administer such sanctions under 15 U.S.C. § 78*o* (1982).

duty to the corporation's shareholders as was owed by the insider: either to disclose the information to the public at large or to refrain from trading.[5] Dirks petitioned the United States Court of Appeals for the District of Columbia to review his censure.[6] He contended, in part, that he was not a "tippee"[7] because the information he had obtained consisted of unverified allegations and not "material facts" as required under the securities statutes,[8] but the court of appeals affirmed the censure.[9] On writ of certiorari, the United States Supreme Court, *held*, reversed. A tippee assumes a fiduciary duty to shareholders to disclose material, nonpublic information or refrain from trading only if the insider from whom the information was received has breached his fiduciary duty to the shareholders by the disclosure and the tippee knows, or has reason to know, that such a breach has occurred. *Dirks v. Securities and Exchange Commission*, 103 S. Ct. 3255 (1983).

The Securities Exchange Act of 1934[10] was enacted in an attempt by Congress to control the fraudulent and manipulative practices in the securities industry that lead to the stock market crash of 1929.[11] One of the basic purposes of this Act was to insure that fair and honest markets would be maintained to prevent sudden and unreasonable

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[5] 103 S. Ct. at 3261-62 (quoting *In re* Dirks, 21 S.E.C. Docket 1401, 1410 n.42 (1981)).

[6] *Id.* at 3260.

[7] A "tippee" has been defined as a person who has been given information by insiders in a breach of trust. *See* Ross v. Licht, 263 F. Supp. 395, 410 (S.D.N.Y. 1967).

[8] 103 S. Ct. at 3266 n.25.

[9] Dirks v. SEC, 681 F.2d 824, 846 (D.C. Cir. 1982), *rev'd*, 103 S. Ct. 3255 (1983). The appellate court entered judgment for the reasons stated by the Commission in its opinion. 681 F.2d at 837-39. The Commission had stated that Dirks "willfully disseminated material facts, whch [sic] he knew were from inside corporate cources [sic] and were nonpublic, under circumstances where fraudulent sales of EFCA securities were reasonably likely to—and did—result." *In re* Dirks, 21 S.E.C. Docket at 1401, 1407 (1981).

Judge Wright, in the appellate court's opinion, stated that "the obligations of corporate fiduciaries pass to all those to whom they disclose their information before it has been disseminated to the public at large." 681 F.2d at 839. Judge Wright also concluded that Dirks, as an employee of a broker-dealer, had violated "obligations to the SEC and the public completely independent of any obligation acquired" as a result of the information he received from the tipper. 681 F.2d at 840.

[10] 15 U.S.C. §§ 78a-78hh (1976). The pre-1929 rising market was accompanied by fraud, which played at least some role in the eventual crash of 1929. R. DE BEDTS, THE NEW DEAL'S SEC: THE FORMATIVE YEARS 4-12 (1964).

[11] Crane, *An Analysis of Causation Under Rule 10b-5*, 9 SEC. REG. L.J. 99, 116 (1981). Congress also enacted other legislation with a similar purpose. *See, e.g.*, Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1982); Trust Indenture Act of 1939, 15 U.S.C. §§ 77aaa-77bbbb (1982); Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 - 80a-64 (1982); Investment Advisors Act of 1940, 15 U.S.C. §§ 80b-1 - 80b-21 (1982).

price fluctuations in securities.[12] To this end, section 10(b)[13] of the Act gave to the SEC the power to promulgate rules proscribing the use of manipulative or deceptive devices in connection with the purchase or sale of securities.[14] It was not until 1942, however, that the SEC, exercising its section 10(b) power,[15] adopted rule 10b-5, a broad antifraud provision.[16] The courts initially interpreted rule 10b-5 by applying concepts of common-law fraud,[17] which required that a fiduciary relationship be breached before the rule was violated,[18] but subsequent inter-

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[12] *See* Securities Exchange Act of 1934 § 2, 15 U.S.C. § 78(b) (1982).

[13] 15 U.S.C. § 78j (1976).

[14] *See* 15 U.S.C. § 78j (1982). Section 10(b) was actually intended to serve as a "catchall provision," preventing fraud in the sale and purchase of securities. Note, *Chiarella v. United States*, 15 Loy. L.A.L. Rev. 177, 182 (1981). When Thomas Corcoran, the Roosevelt administration's spokesperson, described the bill in the legislative hearings, he said of § 10, "Subsection [(b)] says, 'Thou shalt not devise any other cunning devices.'" *Stock Exchange Regulations, Hearings on H.R. 8720 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 2d Sess. 115 (1934).

[15] Jacobs, *The Impact of Security Exchange Act Rule 10b-5 on Broker-Dealers*, 5 Cornell L. Rev. 869, 870 (1972). Up until 1942, § 10(b) was given little attention. *Id.* Scholars have suggested that § 10(b) may have remained relatively unimportant during the years just after its passage for two reasons: (1) § 10(b) was not self-operative but required the issuance of rules and regulations for its implementation, and (2) the scope of the authority granted to the SEC under § 10(b) was uncertain because of the use of broad language in the statute. Comment, *SEC Rule 10b-5: A Recent Profile*, 13 Wm. & Mary L. Rev. 860, 860-61 (1972).

[16] Jacobs, *supra* note 15, at 870. Judicial interpretation of rule 10b-5 has provided a broad range of remedies. From the inception of rule 10b-5 it was understood that breaches could result in criminal or administrative sanctions. Jacobs, *supra* note 15, at 870. *See, e.g.*, 15 U.S.C. § 78ff (1982) (SEC may require compliance with its rules); 15 U.S.C. § 78*o* (1982) (allowed SEC to censure, limit activity, suspend and revoke registration). Not until 1971 did the Supreme Court acknowledge a private right of action under rule 10b-5. Superintendent of Ins. v. Bankers Life & Casualty, 404 U.S. 6, 13 (1971). However, courts had found private rights of action to exist before 1971. *See* Shell v. Hensley, 430 F.2d 819, 824 (5th Cir. 1970) (individual right of action implied under rule 10b-5 may be invoked on behalf of corporation in shareholder's derivative suit). Eradication of the private right of action would have been "virtually unthinkable" and might had led to "incalculable and possibly unacceptable effects upon the SEC's entire enforcement program." 2 A. Bromberg & L. Lowenfels, Securities Fraud and Commodities Fraud § 5.7 (100) (1982).

[17] Crane, *supra* note 11, at 101.

[18] Crane, *supra* note 11, at 105. *See* Restatement (Second) of Torts § 551(2)(a) (1976) (party to business transaction is under duty to disclose if relationship with other party is that of a fiduciary).

An obligation to disclose arose under common law from a relationship between a corporate insider and the corporate shareholders, making misrepresentations calculated to induce reliance upon them fraudulent. Chiarella v. United States, 445 U.S. 222, 227-28 (1980). However, one who had not disclosed material information before the consumma-

pretation moved away from the narrow concepts of common-law fraud.[19] The cases following traditional common-law concepts generally recognized only corporate officers and directors[20] as having a fiduciary duty to shareholders, whereas later cases have expanded the concept of fiduciary duty to include employees,[21] tippees,[22] partnerships,[23] newspaper columnists,[24] and corporate brokers.[25]

The SEC first construed actions under rule 10b-5 to be broader than actions at common law in *In re Cady, Roberts and Co.*[26] In that case, a securities broker received information about an imminent reduction in dividend payments from a corporate director who was also a representative of the securities broker. The broker traded on the basis of that information before it was publicly disclosed.[27] In holding that the tippee had breached rule 10b-5, the SEC did not rely on the common law concept of a breach of fiduciary duty. Instead, the SEC based its decision on the presence of a relationship that gave access to inside information.[28] *Ross v. Licht*[29] elaborated the *Cady, Roberts* approach

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tion of a transaction had committed fraud only if he had been under a duty to disclose. *Id.* at 228. That duty could arise only if a party had information that the other party had a right to know because of a fiduciary relationship of trust and confidence between the two. *Id.*

[19] Crane, *supra* note 11, at 101. *See infra* notes 27-51 and accompanying text.

[20] *E.g.*, Hotchkiss v. Fischer, 136 Kan. 530, 16 P.2d 531, 535 (1932) (directors acted in fiduciary capacity and within relationship of scrupulous trust and confidence); Stewart v. Harris, 69 Kan. 498, 77 P. 277, 279 (1904) (defendant bank president occupied position of quasi-trustee and owed fiduciary duty to shareholders).

[21] *E.g.*, SEC v. Texas Gulf Sulphur, 401 F.2d 833, 842 (2d Cir. 1968) (employees held liable under rule 10b-5 for trading on basis of knowledge of mineral strike), *cert. denied*, 394 U.S. 976 (1969); Ross v. Licht, 263 F. Supp. 395, 409 (S.D.N.Y. 1967) (employees of corporation were insiders because they had positions giving them access to information intended for corporate purposes only and not for personal benefit).

[22] *E.g.*, Ross v. Licht, 263 F. Supp. 395, 410 (S.D.N.Y. 1967) (tippees were held to same duty as corporate insiders).

[23] *E.g.*, Blau v. Lehman, 368 U.S. 403, 409 (1962) (because partnership could serve as director, partnership could be held to fiduciary duty).

[24] Zweig v. Hearst Corp., 594 F.2d 1261, 1271 (9th Cir. 1979) (newspaper columnist had duty to disclose ownership of stock which he recommended in column).

[25] *E.g.*, Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 235-36 (2d Cir. 1974) (brokerage firm which was prospective underwriter held liable to corporation).

[26] 40 S.E.C. 907 (1961).

[27] *Id.* at 908-09. The securities broker was a partner in a brokerage firm which sold 2000 shares of corporate stock immediately after the corporation decided to cut its dividend rate, but before that information was disclosed to the public. The insider/director informed the broker of the dividend cut by telephoning him during a recess of the meeting at which the cut was decided upon. *Id.*

[28] *Id.* at 912. In explaining this relationship, the Commission stated:

by holding liable tippees who were neither directors nor officers of a corporation. In *Ross* three dentists traded on the basis of information obtained from insiders.[30] The court applied the *Cady, Roberts* test for establishing a duty based on a relationship giving access to information to treat the dentists-tippees as insiders.[31]

In 1968, the Second Circuit declared an even broader scope of liability in *SEC v. Texas Gulf Sulphur Co.*[32] The court held that *anyone* who possessed material inside information was under a duty to disclose to the investing public or abstain from trading in and recommending the securities.[33] This rule was applied to several officers and employees of Texas Gulf Sulphur Company who had learned of a promising min-

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> Analytically, the obligation rests on two principal elements; first, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, [footnote omitted] and second, the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing.

Id.

The Commission also explained that its task was to identify those parties who were in a "special relationship" with a corporation, were "privy to its internal affairs," and who were, therefore, held to correlative duties of restraint when trading in that corporation's securities. *Id.* Such persons were required to disclose before trading or abstain from trading altogether. *Id.* at 911.

The Commission also pointed out that "although the primary function of rule 10b-5 was to extend a remedy to a defrauded seller, the courts and this Commission have held that it is also applicable to a defrauded buyer." *Id.* at 913. *See also* Ellis v. Carter, 291 F.2d 270, 273 (9th Cir. 1961) (no demonstration given that Congress did not intend buyers to have same remedy as sellers); Matheson v. Armbrust, 284 F.2d 670, 674 (9th Cir. 1960) (no distinction between buyers and sellers under § 10(b)), *cert. denied*, 365 U.S. 870 (1961); Fischman v. Raytheon Mfg. Co., 188 F.2d 783, 786-87 (2d Cir. 1957) (it is "untenable" that defrauded purchasers would have no remedy).

[29] 263 F. Supp. 395 (S.D.N.Y. 1967).

[30] *Id.* at 398. *Ross* involved an action by sellers of stock against a corporation, stockholders, officers, and tippees, claiming that the defendants bought plaintiff's stock at $120 per share while possessing knowledge of one proposal to sell approximately 100 shares of stock privately for $300 per share and another proposal to sell 500 shares at $600 per share in a public offering. *Id.* at 398-403.

[31] *Id.* at 409. *Cady, Roberts* had defined an insider as a person occupying a relationship giving access to information intended only for a corporate purpose and not for anyone's benefit. 40 S.E.C. at 912. Because the ordinary tippee did not fit that definition, some confusion resulted. Comment, *supra* note 15, at 933. *Ross*, however, offered as an alternative basis for liability the finding that the defendants, even if merely tippees and not insiders, would have been liable for aiding and abetting a violation of rule 10b-5. *See* 263 F. Supp. at 410.

[32] 401 F.2d 833 (2d Cir. 1968) (en banc), *cert. denied*, 394 U.S. 976 (1969).

[33] 401 F.2d at 848.

eral strike by the company and traded on the basis of that information before it was disclosed.[34] The employees had also relayed the information to a number of investors, who then speculated on the basis of the tip.[35] However, none of these tippees were defendants in the suit, and the court did not decide whether the actions of these tippees violated rule 10b-5. The court did note, however, that the actions of the tippees were certainly as "reprehensible" as those of the corporate insiders.[36] The court based its expansive reading of the antifraud provisions on the need to maintain a parity of access to market information.[37]

In *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,[38] the Second Circuit was squarely faced with the problem of defining the duty of tippees who traded on the basis of non-public information. Merrill Lynch, through its role as financial advisor and underwriter for Douglas Aircraft, had obtained information regarding the poor performance of Douglas. This confidential information was relayed to certain investors, who immediately sold their Douglas stock to minimize losses.[39] The court relied on *Texas Gulf* in applying the disclose-or-abstain rule to the tippees, and found them guilty of violating rule 10b-5.[40] However, the court did not wholeheartedly embrace the "parity of information" theory advanced in *Texas Gulf*. In holding the tippees subject to the disclose-or-abstain rule, the court noted that the tippees had either actual or constructive knowledge of the confidential corpo-

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[34] *Id.* at 839-42. The court also held that the corporation itself could, on remand, be found liable for its failure to disclose the information accurately. *Id.* at 863-64.

[35] *Id.* at 841 n.4.

[36] *Id.* at 852-53.

[37] The court stated that "the Rule is based in policy on the justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material information." *Id.* at 848. For an interesting article on the *Texas Gulf Sulphur* controversy, see Fleischer, *Securities Trading and Corporate Information Practices: The Implications of the* Texas Gulf Sulphur *Proceeding*, 51 VA. L. REV. 1271 (1965).

[38] 495 F.2d 228 (2d Cir. 1974).

[39] 495 F.2d at 241. Merrill Lynch acted as an underwriter for Douglas Aircraft Co. in the matter of an offering by Douglas of a new issue of debentures. Merrill Lynch learned of revised lower earnings projections for Douglas through its position as underwriter and disclosed this information to certain of its customers who proceeded to sell more than 165,000 shares of Douglas stock in a four-day period. This represented almost half of the shares of Douglas stock sold on the New York Stock Exchange during that period. Merrill Lynch received commissions on these transactions, which all occurred before Douglas reported its revised earnings to the public. *Id.* at 231-32.

[40] *Id.* at 241. The court held Merrill Lynch and the tippees liable for damages to the plaintiffs who had traded in or recommended trading in Douglas stock without benefit of the information during the same period. *Id.*

rate source of the earnings information, and that they were aware of its non-public nature.[41] The court thus reflected the concerns expressed in a concurrence in *In re Investors Management Co.*,[42] the resulting opinion in an SEC inquiry arising from the same set of transactions. The Commission had censured Merrill Lynch and its tippees after finding them to be subject to the disclose-or-abstain rule.[43] The Commission had held that a tippee need only have "reason to know" of the non-public nature of the information—not actual knowledge of a breach of fiduciary duty in the release of that information—in order for there to be a duty to abstain or disclose.[44] Commissioner Smith, in concurrence, reformulated this requirement to focus on the conduct of the corporate insiders, rather than on parity of information, in determining the duty of tippees.[45] This reformulation would require actual or constructive knowledge by the tippee that the information became available through a breach of fiduciary duty owed by the insider to the corporation.[46] The result of this approach would be to relate the duty of the tippee to the duty of the insider, so that a tippee's duty to abstain or disclose would depend on the tippee's knowledge of a breach of fiduciary duty by the insider.[47]

The Supreme Court indicated in *Chiarella v. United States*[48] that

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[41] *Id.* at 238. The court based the culpability of the tippees on the fact that they "knew or should have known of the confidential corporate source of the revised earnings information and they knew of its non-public nature." *Id.*

[42] 44 S.E.C. 633 (1971).

[43] *Id.* at 641. The Commission considered the necessary elements for the imposition of a duty to abstain or disclose to be:

> 1. Materiality and non-public nature of the information,
>
> 2. Actual or constructive knowledge on the part of the tippee that the information was non-public and had been obtained *improperly* by selective revelation or otherwise, and
>
> 3. Importance of the information in the decision to effect the transaction.

Id. [Emphasis added].

[44] *Id.*

[45] *Id.* at 648. The Commissioner objected to the idea of policing the possession of information as impracticable. He argued that the concept of "relative informational advantages" was too vague to be applied with consistency. *Id.* Furthermore, the Commissioner feared that a rule which based liability on the possession of informational advantages would penalize or thwart the quest for new knowledge carried on by analysts and researchers; he felt the research carried on by these specialists makes a valuable contribution to more informed investing and consequently to more accurate market pricing. *Id.* at 649.

[46] *Id.* at 650. The Commissioner noted that such knowledge would, in effect, make the tippee a participant in the breach when he acted on the basis of the tip. *Id.*

[47] *Id.* at 651.

[48] 445 U.S. 222 (1980).

it was prepared to adopt the approach urged by Commissioner Smith. The petitioner in *Chiarella*, an employee of a financial printer, had been convicted of violating rule 10b-5 for trading on the basis of information he received through his job.[49] The Supreme Court reversed his conviction, holding that a duty to disclose arose only where there was a fiduciary relationship—not where there was merely possession of nonpublic market information.[50] In a footnote, the Court noted that in cases such as *Shapiro*, where tippees were found to have a duty to abstain or disclose, the obligation was viewed as arising from the tippee's role as a "participant after the fact in the insider's breach of a fiduciary duty."[51] This implied participation was based on the tippee's knowledge of the confidentiality of the information, and his knowledge that the information came from a corporate insider.[52] A United States District Court, in *SEC v. Platt*,[53] interpreted the *Chiarella* footnote as an indication that tippees share in the fiduciary duty along with the insider if they know the information they possess is confidential and

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[49] *Id.* at 224-25. Petitioner handled documents concerning unannounced corporate takeover bids. Petitioner was able to deduce the identity of the target companies, and speculated in those companies' stocks without disclosing his knowledge of the pending takeover bid. By so doing, petitioner gained $30,000 within 14 months. *Id.* at 224.

[50] *Id.* at 235. In reversing Chiarella's conviction, the Court refused to recognize a general duty among all people in market transactions to forgo transactions based on nonpublic information. *Id.* at 233. The Court stated that such a broad duty would radically depart from the established doctrine that a duty arose only where there was a special relationship among the parties. *Id.* (citing RESTATEMENT (SECOND) OF TORTS § 551(2)(a) (1976)).

The Court found that neither Congress nor the SEC had adopted such a broad rule mandating parity of access to information, even though detailed regulations existed to govern the use of market information. 445 U.S. at 233. In the absence of explicit evidence of congressional intent, the Court declined to adopt such a rule. *Id.* The Court concluded that congressional action was inconsistent with the broad rule of duty it was asked to adopt in *Chiarella*. *Id.*

The Court also emphasized that the Securities Exchange Act of 1934 could not be read "more broadly than its language and the statutory scheme reasonably permit." *Id.* at 234 (quoting Touche Ross & Co. v. Redington, 442 U.S. 560, 578 (1979)); *see also* SEC v. Sloan, 436 U.S. 103, 116 (1978) (references to "remedial purposes" of 1934 Act did not justify reading any of its provisions "more broadly than its language and the statutory scheme reasonably permit"); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 200 (1976) (in seeking to accomplish "broad remedial goals," Congress did not adopt simple negligence standard, but congressional intent must be ascertained from language used in particular provisions).

[51] 445 U.S. at 230 n.12.

[52] *Id.*

[53] 565 F. Supp. 1244 (1983).

came from a corporate insider.[54] In such a situation, the tippee becomes a part of the "relationship of trust and confidence" cited in *Chiarella* as the basis for the duty to abstain or disclose.[55]

In the instant case, the Court reasoned that since Dirks was a stranger to Equity Funding,[56] and did not induce anyone in Equity to repose trust in him,[57] he had no independent fiduciary duty to the company or its shareholders.[58] Assuming Dirks was a tippee,[59] under *Chiarella* he could only have a duty to abstain or disclose if there were a breach of fiduciary duty by the insider who was the source of his information.[60] Disclosure of confidential information by an insider is not a breach of fiduciary duty unless it is motivated by an improper motive,[61] such as a desire for personal gain, and since the insiders who gave Dirks the information received no monetary gain or personal benefit,[62] there was no breach of fiduciary duty by the insiders.[63] Consequently, Dirks had no duty to abstain or disclose, and his conviction was reversed.[64]

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[54] *Id.* at 1252-53. *Platt*, an opinion on summary judgment, arose from an action brought by the SEC against several defendants for violations of antifraud provisions of the Securities Exchange Act. Oklahoma football coach Barry Switzer and several associates purchased stocks on the basis of a tip given to Switzer by the chairman of a company preparing to liquidate its assets. *Id.* at 1247-50. The district court found that an issue of material fact was presented by Switzer's actions, and the motion for summary judgment was denied. *Id.* at 1261.

[55] *Id.* at 1253.

[56] 103 S. Ct. at 3267.

[57] *Id.*

[58] *Id.* The Court noted that the lower court judge found that Dirks acquired a fiduciary duty by virtue of his position as an employee of a broker-dealer. The SEC had not argued this theory of fiduciary duty before the Supreme Court, though, and the majority declined to decide the merit of such a theory, other than labeling it "novel." *Id.* n.26.

[59] The Court declined to decide on Dirks' contention that he was not a tippee; Dirks argued that the information he received was not truly "inside" information, since it concerned corporate crime and was not intended for corporate purposes, and that the information did not constitute a "material fact" since it consisted of unverified allegations of fraud. For purposes of this case, the Court assumed Dirks was a tippee of material inside information. *Id.* at 3266 n.25.

[60] *Id.* at 3264.

[61] *Id.* at 3265.

[62] *Id.* at 3267-68. The Court noted that a violation of rule 10b-5 required a showing of fraud on the part of the insider. The insider's actions in this case, however, were motivated by a desire to disclose fraud; the insider received no personal benefit "under any objective standard." *Id.* at 3267 n.27.

[63] *Id.* at 3267-68.

[64] *Id.* at 3268.

In dissent,[65] Justice Blackmun[66] reasoned that since the shareholders' injury was not eradicated by the lack of personal benefit flowing to the insider, then personal gain was not an element of the breach of duty.[67] Therefore, since the insiders had violated their duty to the shareholders by relaying material, non-public information to the petitioner with the intention that petitioner advise his clients to trade on the information, then petitioner had been under a duty to disclose the information or refrain from activity which would lead to trading.[68] Since the petitioner did not disclose but instead caused his clients to trade, he violated rule 10b-5.[69]

Dirks marks the acceptance by the Supreme Court of the views espoused by Commissioner Smith, in his concurrence to *In re Investors Management Co.*,[70] that the parity of information rule established in *Cady, Roberts* and *Texas Gulf* swept too broadly, penalizing large numbers of analysts and others who were strategically located in positions giving them access to non-public, but properly obtained, information.[71] Prior to *Dirks*, the trend was toward expansion of rule 10b-5 into a "universal fraud remedy."[72] With *Dirks*, the Supreme Court has re-emphasized the role of the insider in determining whether a tippee has a duty to abstain or disclose.[73] Justice Blackmun's dissent accurately notes that the shareholders suffer financial loss regardless of the propriety of the insider's motives in releasing the information to the

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[65] *Id.*

[66] Justice Brennan and Justice Marshall joined in the dissent. *Id.*

[67] *Id.* at 3271. *Cf.* Mosser v. Darrow, 341 U.S. 267, 275 (1951) (trustee liable for activities harmful to trust despite his devotion and selfless motives); RESTATEMENT (SECOND) OF TRUSTS § 205 comments c and d (1959) (trustee would be liable for acts which cause diminution in value of trust); 3 A. SCOTT, THE LAW OF TRUSTS § 205, at 1665 (1967) (trustee liable for any losses to trust caused by his breach).

[68] 103 S. Ct. at 3274. Justice Blackmun admitted that disclosure would have been difficult because although the SEC has required those with inside information to refrain from trading without disclosing, it has refused to tell them how to disclose. *Id.* at 3273.

[69] *Id.* at 3274. The dissent notes that the overall effect of the petitioner's "selective dissemination" of the information was to shift inevitable losses of the Equity Funding fraud from the petitioner's clients to "uninformed market participants." *Id.* at 3269. The petitioner's efforts to disseminate the inside information to nonclients were characterized by the dissent as "feeble, at best." *Id.* at 3269.

Justice Blackmun viewed the majority opinion as one more step toward limiting protections offered to investors by § 10(b) of the Securities Exchange Act of 1934. *Id.* at 3268 & n.1.

[70] *See supra* notes 46-48 and accompanying text.

[71] *See* 103 S. Ct. at 3264 n.16.

[72] Comment, *supra* note 15, at 938.

[73] *See supra* notes 61-64 and accompanying text.

tippee.[74] The majority is cognizant of this problem, but is of the opinion that such a loss results from trading that may be unethical, but which is nevertheless legal.[75]

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[74] *See supra* note 70 and accompanying text.
[75] 103 S. Ct. at 3265 n.21.

Civil Rights—Attorneys' Fees—When Lodestar Adjusting Factors Are Considered in Initial Lodestar Computation, No Abuse of Discretion for District Court to Reject Further Adjustments Based Upon Same Factors

On remand from the United States Court of Appeals for the Fifth Circuit,[1] defendants,[2] pursuant to 42 U.S.C. § 1988,[3] made a motion for an award of costs and attorneys' fees in the United States District Court for the Southern District of Mississippi.[4] Following the district

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[1] This cause arose out of a controversy over the use of the name "Democratic Party" in Mississippi. Riddell v. National Democratic Party, 344 F. Supp. 908, 909-10 (S.D. Miss. 1972). Plaintiffs were officers, delegates and electors of a group registered under Miss. Code Ann. § 3107-01 (1942) (current version at Miss. Code Ann. § 23-1-5 (1972)) as the "Democratic Party of Mississippi." *Riddell,* 344 F. Supp. at 910, 913. By registering under the statute, plaintiffs claimed entitlement to the exclusive right to use the name. *Id.* at 913. Plaintiffs filed suit to enjoin defendants from using the name "Democratic Party." *Id.* at 910. Defendants counterclaimed under 42 U.S.C. § 1983 (Supp. V 1981), contending that the Mississippi statute was unconstitutional. Riddell v. National Democratic Party, 508 F.2d 770, 774 (5th Cir. 1975). The United States District Court for the Southern District of Mississippi held for plaintiffs. *Riddell,* 344 F. Supp. at 923. On appeal, the United States Court of Appeals for the Fifth Circuit reversed and remanded, finding the state statute unconstitutional as an impermissible restraint on the first amendment's free association guarantee. *Riddell,* 508 F.2d at 779.

[2] Defendants were officers of a political organization known as the "Freedom Democratic Party." *Riddell,* 508 F.2d at 773. The party was seated as the official Mississippi delegation at the 1968 Democratic National Convention. Also joined as defendants in the instant action were the National Democratic Party and the Democratic National Committee. In their counterclaim, defendants joined the Governor, Secretary of State, and Attorney General of Mississippi as counter-defendants. *Id.*

[3] 42 U.S.C. § 1988 (Supp. V 1981) provides in part:

> In any action or proceeding to enforce a provision of sections 1981, 1982, 1983, 1985, and 1986 of this title, title IX of Public Law 92-318 . . . , or title VI of the Civil Rights Act of 1964 . . . , the court, in its discretion, may allow the prevailing party, other than the United States, a reasonable attorney's fee as part of the costs.

Id.

Although the Civil Rights Attorney's Fee Awards Act of 1976, Pub. L. No. 94-550, 90 Stat. 2641 (codified as amended at 42 U.S.C. § 1988 (1976)) had not been enacted when the initial complaint was filed, the statute has been construed to apply to cases pending when it was enacted. *See* Hutto v. Finney, 437 U.S. 678, 694 n.23 (1978).

[4] Riddell v. National Democratic Party, 624 F.2d 539, 543 (5th Cir. 1980). In May, 1977, leaders from both groups met and agreed to form a unified party. The parties to the lawsuit submitted to the district court an agreed order of dismissal stating that the dispute had become moot as a result of the merger. The order provided, however, that the issue of costs would be reserved. *Id.* at 542-43.

court's denial of relief,[5] the Fifth Circuit, on appeal, reversed and remanded.[6] On remand,[7] the district court awarded defendants $95,235.48[8] in attorneys' fees but allowed no adjustment of the lodestar[9] figure, reasoning that the adjustment factors[10] had been taken into consideration in computing the lodestar.[11] Defendants argued on appeal that the district court had erred in failing to increase the award of attorneys' fees after the lodestar computation.[12] On appeal, the United States Court of Appeals for the Fifth Circuit, *held,* affirmed in part, reversed and remanded in part. Failure to adjust the lodestar of an attorneys' fee award on the basis of prescribed adjustment factors is not an abuse of discretion when those same factors are considered in the initial lodestar computation. *Riddell v. National Democratic Party,* 712 F.2d 165 (5th Cir. 1983).

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[5] *Id.* at 543. The district court concluded that an award of attorneys' fees might disrupt the newly unified Democratic Party. The court noted that after the merger, plaintiffs' Democratic Party had transferred to the unified Democratic Party funds which were used to pay defendants' debts. *Id.*

[6] *Id.* at 547.

[7] Riddell v. National Democratic Party, 545 F. Supp. 252 (S.D. Miss. 1982).

[8] *Id.* at 263. In calculating this figure, the district court concluded that the reasonable hourly rate for the Jackson, Mississippi, area was $87.20 and that the number of hours reasonably spent on the case by defendants' attorneys was 1092.15. *Id.* at 261. The court multiplied these figures to determine the amount of the award. The court noted that plaintiffs' counsel failed to offer proof that the hourly rate was less than $87.20. *Id.*

[9] For a discussion of the lodestar concept, see *infra* notes 23-28 and accompanying text.

[10] For a discussion of the adjustment idea, see *infra* notes 26-28 and accompanying text.

[11] *Riddell,* 545 F. Supp. at 263.

[12] Riddell v. National Democratic Party, 712 F.2d 165, 169 (5th Cir. 1983). Defendants contended that some of the factors normally considered as adjustments to the lodestar were ignored and that others were improperly taken into account in determining the lodestar. Specifically, they argued that, given the contingent nature of the case, the experience of the attorneys, and the preclusion of other work, the fee was so low as to constitute an abuse of discretion. Defendants also argued that the district court erred in not allowing pre-litigation expenses, travel time, and time spent preparing the attorneys' fee application. *Id.*

The state officials appealed the district court's imposition of joint and several liability for payment of the fee award. *Id.* at 167. In response to the Fifth Circuit's order to "devise an equitable plan for allocating" payment of the award, the district court concluded that the only equitable approach was to hold the State and the "Democratic Party of Mississippi" jointly and severally liable. The district court was unable to find case authority on the question of allocating attorneys' fees between joint defendants. *Riddell,* 545 F. Supp. at 263. The state officials contended that joint and several liabilty was contrary to the Fifth Circuit's mandate following the prior appeal. *Riddell,* 712 F.2d at 168.

Although the traditional American rule has required each party to a lawsuit, whether successful or unsuccessful, to pay its own attorney's fee,[13] several exceptions have been created.[14] Chief among these have been congressional authorizations of attorneys' fees in various types of federal public interest litigation.[15] Virtually all of the statutes provided that the amount awarded should be reasonable.[16] In enacting the statutes, Congress often did not specify any guidelines for determining what is reasonable, but left this matter to the discretion of the courts.[17] This standard created problems for the federal courts.[18] For example, many lower courts awarded attorneys' fees without discussing or iden-

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[13] *See* Arcambel v. Wiseman, 3 U.S. (3 Dall.) 306, 306 (1796) (general practice in United States is opposed to awarding counsel fees); *see also* Fleischmann Distilling Corp. v. Maier Brewing Co., 386 U.S. 714, 717 (1976) (attorneys' fees not recoverable in absence of statute or contract).

[14] *See, e.g.*, Boeing Co. v. Van Gemert, 444 U.S. 472, 481 (1980) (absentee class members must contribute proportionately to attorneys' fees in successful class action); Hall v. Cole, 412 U.S. 1, 5 (1973) (expelled union leader entitled to attorneys' fees due to management's bad faith expulsion). *See generally* Thueson, *Attorney Fees: Slipping From the American Rule Strait Jacket*, 40 MONT. L. REV. 308, 309-18 (discussion of court-created exceptions to American rule); Comment, *The Discretionary Award of Attorneys' Fees by the Federal Courts: Selective Deviation From the No-Fee Rule and the Regrettably Brief Life of the Private Attorney General Doctrine*, 36 OHIO L.J. 588, 601 (1975) (same).

[15] *See, e.g.*, 15 U.S.C. § 15 (1982) (fee award for antitrust actions); 42 U.S.C. § 2000e-5(k) (1976) (attorneys' fees for employment discrimination cases). *See generally* Berger, *Court-Awarded Attorneys' Fees: What is "Reasonable"?*, 126 U. PA. L. REV. 281, 303 n.104 (1977) (lists 75 federal statutes authorizing fee awards).

[16] *E.g.*, 42 U.S.C. § 1988 (1976) (court may allow reasonable attorneys' fees as part of costs); 42 U.S.C. § 2000e-5(k) (1976) (same). *But see* 18 U.S.C. § 3006 A(d) (1976) (sets maximum rates for court-appointed attorneys in criminal cases); 38 U.S.C. § 784(g) (1976) (limiting attorneys' fees to not more than 10% of recovery in serviceman's or veteran's insurance claim).

[17] *See* 42 U.S.C. § 1988 (1976) (allowing attorneys' fees as part of costs, in court's discretion); *see also* 42 U.S.C. § 2000e-5(k) (1976) (same). One exception is the Consumer Product Safety Commission Improvement Act of 1976, 15 U.S.C. § 2059(e)(4) (Supp. 1977), which prescribes standards to be used in computing a "reasonable attorney's fee":

> [A] reasonable attorney's fee is a fee (A) which is based upon (i) the actual time expended by an attorney in providing advice and other legal services in connection with representing a person in an action brought under this subsection, and (ii) such reasonable expenses as may be incurred by the attorney in the provision of such services, and (B) which is computed at the rate prevailing for the provision of similar services with respect to actions brought in the court which is awarding such fee.

[18] *See, e.g.*, Johnson v. Georgia Highway Express, 488 F.2d 714, 717 (5th Cir. 1974) (requiring consideration of 12 factors when district court failed to explain factors it considered in making fee award).

tifying the factors considered in the court's calculation.[19] This practice made appellate review of the awards difficult, if not impossible.[20]

To eliminate this problem, the Third Circuit in *Lindy Brothers Builders, Inc. v. American Radiator & Standard Sanitary*,[21] developed a two-step formula for computing a reasonable attorneys' fee.[22] Under this approach, the district court should first ascertain the number of hours reasonably spent by the attorneys on the case in question,[23] and then determine a reasonable hourly rate for those services.[24] These two figures are then multiplied together in order to arrive at a lodestar figure.[25] Finally, the lodestar amount should be adjusted,[26] at the discretion of the court, to account for such factors as the contingent nature of the case[27] and the overall quality of the work.[28]

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[19] *See, e.g.*, Canterbury v. Dick, 385 F. Supp. 1004, 1009 (S.D. Tex. 1973) (court merely stated that $2,750.00 was reasonable for services rendered); *see also* Kerr v. Screen Extras Guild, Inc., 526 F.2d 67, 69 (9th Cir. 1975) (district court explained simply that amount set was "reasonable under all the circumstances").

[20] *See* Monroe v. County Bd. of Educ., 505 F.2d 109, 112 (6th Cir. 1974) (appellate review of adequacy of attorneys' fees award must depend upon some record of lower court's decision); *see also* Evans v. Sheraton Park Hotel, 503 F.2d 177, 188 (D.C. Cir. 1974) (appellate court "in the dark" as to trial judge's finding of time, labor, and rate of compensation).

[21] 487 F.2d 161 (3d Cir. 1973).

[22] *Id.* at 166-67. The court observed that a trial judge's mere listing of the elements considered in setting a fee award makes any meaningful review difficult and provides little guidance to attorneys and litigants. *Id.*

[23] *Id.* The court added that the precise number of hours spent on each part of the case was not necessary, but that some "fairly definite" information concerning the hours spent on general activities would be required. Notably, a few courts have imposed penalties in cases where attorneys fail to keep hourly records of their work time. *Id.; see, e.g.*, Ross v. Saltmarsh, 521 F. Supp. 753, 762 (S.D.N.Y. 1981) (ten percent reduction for total reconstruction of attorney's records; five percent penalty for partial reconstruction); Kane v. Martin Paint Stores, Inc., 439 F. Supp. 1054, 1056 (S.D.N.Y. 1977) (10% penalty imposed for failure to keep precise records), *aff'd mem.*, 578 F.2d 1368 (2d Cir. 1978).

[24] *Lindy*, 487 F.2d at 167. The *Lindy* court emphasized that, while the value of an attorney's service is usually reflected by his hourly billing rate, the attorney's reputation, position, and experience, as well as the nature of the services rendered, should also be considered in computing an hourly rate. *Id.*

[25] *Lindy*, 487 F.2d at 167. The *Lindy* court emphasized that calculating this initial lodestar figure provided the "only reasonable objective basis" for valuing an attorney's services. *Id.; accord* City of Detroit v. Grinnell Corp., 495 F.2d 448, 471 (2d Cir. 1974) (lodestar calculation is "the only legitimate starting point for analysis").

[26] *Lindy*, 487 F.2d at 167-68. The court stated that an hours-times-rate computation should be the beginning point, but that other factors had to be considered to complete the inquiry. *Id.*

[27] According to the *Lindy* court, the contingency factor should be given "special significance" because an attorney whose payment is contingent on success is not ex-

Following *Lindy*, other jurisdictions adopted the lodestar method of computing a reasonable attorneys' fee.[29] In *Johnson v. Georgia Highway Express, Inc.*,[30] the Fifth Circuit took a somewhat different approach by specifying twelve factors to be considered by the district courts in calculating fee awards:[31]

(1) The time and labor required.[32]
(2) The novelty and difficulty of the questions involved.[33]
(3) The skill required to perform the legal service properly.[34]
(4) The preclusion of other employment.[35]

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pected to charge as little as he would charge when his client has agreed to pay in advance, regardless of success (quoting Cherner v. Transition Elec. Corp., 221 F. Supp. 55, 61 (D. Mass. 1963)). The court also provided that all information which would establish the likelihood of success should be considered when determining whether the fee should be adjusted to reflect the contingent nature of the case. *Lindy*, 487 F.2d at 168; *cf.* Hughes v. Repko, 578 F.2d 483, 487-88 (3d Cir. 1978) (contingency factor may not be used to decrease the amount of fee award).

[28] *Lindy*, 487 F.2d at 168. The quality of the work should be considered only to adjust the lodestar as a penalty or bonus if the work was "unusually poor or unusually good." The court also required that such factors as the complexity and novelty of the issues, the work as observed by the trial judge, and the amount of recovery were relevant to the evaluation of an attorney's work. In addition, the court considered the amount of recovery to be the most reliable figure on which to base a fee award when the case ended in settlement. *Id.*

[29] *See* Copeland v. Marshall, 641 F.2d 880, 891 (D.C. Cir. 1980) (adopted *Lindy's* "analytical framework" for use in the District of Columbia Circuit); City of Detroit v. Grinnell Corp., 495 F.2d 448, 470 (2d Cir. 1974) (adopted guidelines stated in *Lindy*).

[30] 488 F.2d 714 (5th Cir. 1974).

[31] *Id.* at 717-19. Although the *Johnson* case involved a claim of employment discrimination under Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000(e) (1976), the fee calculation factors have been applied in a variety of other areas. *See, e.g.*, Barber v. Kimbrell's, Inc., 577 F.2d 216, 226 (4th Cir.) (Truth in Lending Act), *cert. denied*, 439 U.S. 934 (1978); Rainey v. Jackson State College, 551 F.2d 672, 676 (5th Cir. 1977) (Attorney's Fee Awards Act).

[32] *Johnson*, 488 F.2d at 717. The award should not be based solely on time and labor, but should include the trial judge's evaluation of the hours claimed based upon his knowledge of the time necessary to perform such work. Furthermore, the trial court should distinguish between different types of legal work and scrutinize the possibility of duplication of effort. *Id.*

[33] *Id.* at 718. Although they may acquire knowledge and experience in such litigation, attorneys should always be compensated for assuming the responsibility of challenging existing law. *Id.*

[34] *Id.* The trial judge should rely on his knowledge of the legal profession to evaluate the attorney's work, preparation, and ability. *Id.*

[35] *Id.* An attorney should be compensated when time spent on the client's behalf prevents him from conducting other business. *Id.*

(5) The customary fee.[36]
(6) Whether the fee is fixed or contingent.[37]
(7) Time limitations imposed by the client or the circumstances.[38]
(8) The amount involved and the results obtained.[39]
(9) The experience, reputation, and ability of the attorneys.[40]
(10) The "undesirability" of the case.[41]
(11) The nature and length of the professional relationship with the client.[42]
(12) Awards in similar cases.[43]

The *Johnson* factors, which were largely identical to guidelines recommended in the American Bar Association's Model Code of Professional Responsibility,[44] were primarily aimed at promoting uniformity and al-

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[36] *Id.* A court should consider the usual fee for comparable work in the community. *Id.*

[37] *Id.* Although a fee or percentage the attorney and the client have agreed on is helpful in determining the attorney's fee expectations, reasonableness, rather than the stipulated amount, should control, but the litigant should never be awarded a fee greater than that which he agreed to pay. *Id.* For further discussion of the contingency factor, see *supra* note 27.

[38] *Johnson*, 488 F.2d at 718. Work that takes "priority" may warrant a "premium," especially where the attorney is called in late in the litigation. *Id.*

[39] *Id.* Although the amount of damages recovered would be material, if the results affect a large class of persons, this should be reflected in the attorney's fee. *Id.*

[40] *Id.* An attorney specializing in civil rights cases may be awarded a higher fee for his expertise. *Id.* at 719. Furthermore, while fee scales normally reflect the attorney's experience, a skillful young attorney should be awarded for his greater ability. *Id.* at 718-19.

[41] *Id.* at 719. An attorney's fee should reflect the fact that an attorney's practice could be adversely affected if the case which he has taken is controversial or unpopular. *Id.*

[42] *Id.* The fact that an attorney may reduce his fee when representing a client of long standing should be considered in appropriate cases. *Id.*

[43] *Id.* The reasonableness of the fee should be evaluated in comparison with fee awards in similar litigation in both the Fifth Circuit and other circuits. *Id.*

[44] *See* MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 2-106 (1981) (nearly identical to *Johnson* factors); *cf. In re* Permian Anchor Serv., Inc., 649 F.2d 763, 768 (10th Cir. 1981) (recognizing similarity between DR 2-106 and *Johnson* factors). The Fifth Circuit had earlier affirmed a district court's award of attorneys' fees in which the trial judge relied on DR 2-106. *See* Clark v. American Marine Corp., 437 F.2d 959 (5th Cir. 1971) (per curiam), *aff'g* 320 F. Supp. 709 (E.D. La. 1970). The Seventh Circuit has also applied the standards set forth in DR 2-106. *See* Waters v. Wisconsin Steel Works, 502 F.2d 1309, 1322 (7th Cir. 1974) (applying guidelines in DR 2-106 in conjunction with an hours-times-rates approach). For the probable origin of DR 2-106, see *In re* Osofsky, 50 F.2d 925, 927 (S.D.N.Y. 1931).

lowing rational appellate review of lower courts' attorneys' fee awards.[45]

Although the *Johnson* factors were later followed by a number of jurisdictions,[46] they were also the object of criticism from both the courts[47] and commentators.[48] The criticisms most frequently noted were that the factors merely provided a "checklist" without any direc-

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[45] *In re* First Colonial Corp., 544 F.2d 1291, 1298 (5th Cir. 1977). An award of attorneys' fees will be set aside on appeal only upon a showing that the district court abused its discretion. Weeks v. Southern Bell Tel. and Tel., 467 F.2d 95, 98 (5th Cir. 1972). *See generally* Rosenberg, *Judicial Discretion of the Trial Court, Viewed From Above,* 22 SYRACUSE L. REV. 635, 662-63 (1971) (appellate courts recognized impracticability of reviewing every detail of every case).

The *Johnson* court held that it would constitute an abuse of discretion for the trial judge to fail to consider each of the twelve factors. *Johnson,* 488 F.2d at 720. The Fifth Circuit has subsequently applied this language in remanding several cases. *See* Davis v. Fletcher, 598 F.2d 469, 470 (5th Cir. 1979) (*Johnson* factors must each be considered and accompanied by explanation of how each contributed to decision); *accord* Fain v. Caddo Parish Police Jury, 564 F.2d 707, 709 (5th Cir. 1977) (not only must the trial judge actually consider factors, he must expressly indicate on the record that he has done so). Other circuits adopting the *Johnson* factors have held similarly. *See* Allen v. United States, 606 F.2d 432, 435 (4th Cir. 1979) (court abuses discretion if it allows fee without careful consideration of factors); *accord* O'Neil v. City of Lake Oswego, 642 F.2d 367, 371 (9th Cir. 1981) (unclear from record whether trial court considered other eleven factors). Rather than remanding for failure to consider all of the *Johnson* factors, the Fifth Circuit in Morrow v. Finch, 642 F.2d 823 (5th Cir. 1981), computed the fee on appeal in order to save further litigation costs and attorneys' fees. *Id.* at 824.

[46] *See, e.g.,* Salone v. United States, 645 F.2d 875, 879 (10th Cir. 1981) (*Johnson* guidelines should generally be applied when attorneys' fees are authorized); Barber v. Kimbrell, Inc., 577 F.2d 216, 226 (4th Cir. 1978) (factors must be considered by district courts in arriving at determination of reasonable attorneys' fees); Doe v. Poelker, 515 F.2d 541, 548 (8th Cir. 1975) (same), *rev'd on other grounds,* 432 U.S. 519 (1977). *But cf.* International Travel Arrangers, Inc. v. Western Airlines, Inc., 623 F.2d 1255, 1273-74 (8th Cir. 1980) (*Lindy* approach should be used in determining fee awards in antitrust cases); Grunin v. International House of Pancakes, 513 F.2d 114, 128 (8th Cir.) (*Lindy* provided appropriate test for determining any fee award in class action), *cert. denied,* 423 U.S. 864 (1975). *See generally* E. LARSON, FEDERAL COURT AWARDS OF ATTORNEYS' FEES 148-49 (1981) (in Eighth Circuit, lodestar method is proper; *Johnson* factors may be considered, but only to increase lodestar amount).

The Ninth Circuit has allowed both the *Johnson* and *Lindy* methods. *Compare* Ellis v. Cassidy, 625 F.2d 227, 231 (9th Cir. 1980) (*Johnson* factors must be applied) *and* Kerr v. Screen Extras Guild, Inc., 526 F.2d 67, 70 (9th Cir. 1975) (*Johnson* guidelines are appropriate factors in determining reasonable fee awards), *cert. denied,* 425 U.S. 951 (1976) *with* Stanford Daily v. Zurcher, 64 F.R.D. 680, 682 (N.D. Cal. 1974) (court considered *Johnson* within a modified version of *Lindy), aff'd,* 550 F.2d 464, 466 (9th Cir. 1977).

[47] *See infra* note 50 and accompanying text.

[48] *See, e.g.,* Berger, *supra* note 15, at 286 (*Johnson* factors conflicting and redundant).

tion as to how they should be used[49] and that there was considerable overlap.[50] Despite these criticisms, the legislative history[51] accompanying the Attorney's Fee Awards Act cited *Johnson* as containing the proper standards to be used in calculating fees under the Act.[52] The Senate report referred with approval to *Johnson* and to several district court opinions in which the *Johnson* factors had been applied in determining attorneys' fee awards.[53] Congress reasoned that the awards in these cases had provided adequate compensation to attract competent attorneys without producing exorbitant fee awards.[54]

In recent years, the Fifth Circuit has attempted to provide more guidance for the lower courts in applying the *Johnson* factors. For in-

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[49] Copeland v. Marshall, 641 F.2d 880, 890 (D.C. Cir. 1980). The *Copeland* court stated that the *Johnson* method "offers no guidance on the relative importance of each factor, whether they are to be applied differently in different contexts, or, indeed, how they are to be applied at all." *Id.* (quoting Berger, *supra* note 15, at 286-87); *accord* Northcross v. Board of Educ., 611 F.2d 624, 642 (6th Cir. 1979) (merely providing "checklist" of factors does not lead to consistent results or reasonable fees). *See generally* Dawson, *Lawyers and Involuntary Clients in Public Interest Litigation*, 88 HARV. L. REV. 849, 927 (1975) (listing factors that judges are required to balance is "essentially meaningless litan[y]").

[50] Copeland v. Marshall, 641 F.2d 880, 890 (D.C. Cir. 1980). The "time and labor" element overlaps the "difficulty of the issue" factor because the more difficult the issue the more time it will take to solve it. The hourly fee is also likely to be affected, by the skill necessary to perform the work, the time limitations, the reputations of the attorneys, and the undesirability of the case. *Id.; accord* Northcross v. Board of Educ., 611 F.2d 624, 642 (6th Cir. 1974) (reformulating the process to prevent overlapping).

[51] S. REP. No. 1011, 94th Cong., 2d Sess. (1976), *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 5908.

[52] *Id.* at 6, 1976 U.S. CODE CONG. & AD. NEWS at 5913.

[53] *Id.* (citing Swann v. Charlotte-Mecklenburg Bd. of Educ., 66 F.R.D. 483, 484-86 (W.D.N.C. 1975); Stanford Daily v. Zurcher, 64 F.R.D. 680, 683-87 (N.D. Cal. 1974); Davis v. County of Los Angeles, 8 Empl. Prac. Dec. (CCH) ¶ 9444 at 5048 (C.D. Cal. 1974)). Interestingly, the cases cited in the Senate report did not rely entirely upon the *Johnson* approach but instead used variations of both the *Johnson* and *Lindy* methods. In *Stanford Daily*, the court applied the *Lindy* method by computing a lodestar figure but then considered several of the *Johnson* factors in adjusting the lodestar. *See* 64 F.R.D. at 684-86. In *Swann*, the court did not rely solely on *Johnson* but considered several of its factors. *See* 66 F.R.D. at 484-86. In *Davis*, the court followed *Lindy* by computing a lodestar figure and adjusting it upward to reflect the results achieved and the difficulty of the case. 8 Empl. Prac. Dec. (CCH) at 5047. One commentator has suggested that Congress concluded that the *Johnson* factors are correctly applied through the lodestar model. LARSON, *supra* note 46, at 119.

[54] S. REP. No. 1011, *supra* note 51, at 6, 1976 U.S. CODE CONG. & AD. NEWS at 5913. Congress also stated that the amount of the fee awarded should be governed by the standards of other types of complex federal litigation, such as antitrust suits, and should not be reduced merely because no pecuniary rights were involved. *Id.*

stance, in *In re First Colonial Corp.*,[55] it described a three-step process for calculating reasonable attorneys' fees in bankruptcy courts.[56] First, the nature and extent of the attorney's work must be ascertained.[57] The judge should then determine the value of those services.[58] Lastly, the judge should explain the reasons upon which the award is based and indicate how the *Johnson* factors affected his decision.[59] Thus, while consideration of all the factors listed in *Johnson* was required, special emphasis was placed on the first and fifth *Johnson* factors.[60]

The *Johnson* approach was further modified in *Copper Liquor, Inc. v. Adolph Coors Co.*[61] In *Copper Liquor,* the court reasoned that although all of the *Johnson* factors had to be considered,[62] recent decisions suggested that emphasis should be given to the time and labor involved, the customary fee, the amount involved, and the attorney's experience and reputation.[63] Relying on those decisions, the court concluded that the proper method for computing fee awards was to determine the nature and extent of the attorney's services, value those services according to the customary fee, and adjust that figure on the basis of the other *Johnson* factors.[64] The court acknowledged the similarities between the *Lindy* lodestar approach and the new method of applying the *Johnson* factors as interpreted in *First Colonial* and *Cop-*

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[55] 544 F.2d 1291 (5th Cir.), *cert. denied,* 431 U.S. 904 (1977).

[56] *Id.* at 1299. *See generally* Johnston & Blackburn, *First Colonial: The Fifth Circuit Makes a Definite Statement on the Award of Attorneys' Fees in Bankruptcy,* 24 Loy. L. Rev. 189, 193 (1978) (analyzing *First Colonial*).

[57] *First Colonial,* 544 F.2d at 1299. Attorneys seeking compensation should file a statement containing the number of hours worked and how each hour was spent. *Id.*

[58] *Id.* at 1300. The trial judge should be able to accomplish this step by drawing from his knowledge of fees charged and his experience in evaluating legal work. After these steps are completed, the result should be a reasonable attorneys' fee. *Id.*

[59] *Id.* The court expressly cautioned that its construction of the *Johnson* factors in *First Colonial* was applicable only to the bankruptcy context. *Id.* at 1301.

[60] *See* Note, *Award of Attorney's Fees in the Federal Courts,* 56 St. John's L. Rev. 277, 339 n.279 (1982); *see supra* notes 32, 36, and accompanying text.

[61] 624 F.2d 575 (5th Cir. 1980).

[62] *Id.* at 583.

[63] *Id. See, e.g.,* Mitchell v. Scheepvaart Maatschappij Trans-Ocean, 579 F.2d 1274, 1281 n.10 (5th Cir. 1978) (in "run-of-the-mill" cases, factors one, five, eight, and nine predominate); Rainey v. Jackson State College, 551 F.2d 672, 677 (5th Cir. 1977) (trial court was not "at liberty" to find that hours spent is not reliable source to measure an attorney's fee); *see also* Morrow v. Dillard, 580 F.2d 1284, 1300-01 (5th Cir. 1978) (although time spent by counsel is not "talisman," it must be given "real consideration").

[64] *Copper Liquor,* 624 F.2d at 583. The court noted that a simple "laundry-list" approach to the application of the *Johnson* factors was unlikely to produce a reasonable fee award, and that the trial judge must analyze the relevance and weight of each factor as it applies to a particular case and articulate his reasons for the award. *Id.* at 584.

per Liquor.[65]

More recently, in *Graves v. Barnes,*[66] the Fifth Circuit expressly embraced the lodestar approach as the preferred method.[67] After explaining the lodestar method of computation,[68] the court identified a list of principles to be considered by trial courts in adjusting the lodestar figure.[69] The *Graves* court stated that the two major adjustment factors were the contingent nature of the case and the quality of representation.[70] The court added that the lodestar figure may be adjusted to reflect the contingent factor by using a multiplier, calculated considering the plaintiff's burden,[71] the risks involved in preparing the case,[72] and the delay in receiving payment.[73] In determining whether to adjust the lodestar for the quality of representation, a court should consider the verdict or settlement obtained, the benefit conferred, and the attorney's professional methods of handling the case.[74]

Subsequently, in *Hensley v. Eckerhart*[75] the United States Su-

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[65] *Id.* at 583 n.15.

[66] 700 F.2d 220 (5th Cir. 1983).

[67] *Id.* at 222 (citing *Copper Liquor,* 624 F.2d at 583 n.15).

[68] *Graves,* 700 F.2d at 222. For a discussion of the lodestar method, see *supra* notes 21-28 and accompanying text.

[69] *Id.* at 222-23.

[70] *Id.* For a discussion of these factors, see *supra* notes 34, 37, 40, and accompanying text. Allowing an enhancement of the lodestar for the contingency factor has been criticized. *See* Leubsdorf, *The Contingency Factor in Attorney Fee Awards,* 90 YALE L.J. 473, 474 (1981) (in effort to strengthen contingency factor and therefore increase fee award, prevailing attorney may be tempted to stress client's initial unlikelihood of success). *But see* Hammond, *Stringent New Standards for Awards of Attorneys' Fees,* 32 BUS. LAW 523, 528 (1977) (if not compensated for risk of failure, attorneys would be forced to take only assuredly successful cases, thus eliminating private enforcement of civil rights).

[71] *Graves,* 700 F.2d at 222. The court added that this category subsumed the complexity of the case, the likelihood of defendant's ultimate liability, and whether plaintiff's damages would be difficult to prove. *Id.*

[72] *Id.* This category included the number of hours risked without guarantee of payment, out-of-pocket expenses, and counsel's expertise in the type of case involved. *Id.*

[73] *Id.* The *Graves* court reasoned that such delay should normally be considered in adjusting the award to account for inflation. However, since the trial court computed the lodestar at current hourly rates instead of at the rates which prevailed when the services were actually rendered, it did not need to consider delay in payment as a factor in adjusting the lodestar. *Id.* at 224.

[74] *Id.* at 223. The court emphasized that the contingency factor and the quality of representation should each be separately considered and applied in setting the lodestar. *Id.* In determining an adjustment multiplier, factors considered in the lodestar computation should not be considered again in its adjustment. *Id.* at 224 (citing Copeland v. Marshall, 641 F.2d 880, 893 n.23 (D.C. Cir. 1980)).

[75] 103 S. Ct. 1933 (1983).

preme Court stated that the most useful starting point for computing a reasonable attorneys' fee is to multiply the number of hours reasonably expended by a reasonable hourly rate.[76] The district court may then adjust the fee, particularly considering the results obtained.[77] In a footnote, the Supreme Court added that district courts should also consider other *Johnson* factors, but noted that most of these factors are usually subsumed within the initial calculation.[78]

In the instant case, the court conceded that since the fee was wholly contingent and the case involved significant constitutional ramifications, and since defendants' attorneys had exceptional abilities,[79] the district court's award of attorneys' fees was low.[80] Despite this, however, the court was satisfied that those factors had been taken into consideration in the calculation of the lodestar[81] since the district court had treated the *Johnson* factors extensively[82] and determined that the lodestar figure was the amount that should be awarded.[83] In conclusion the court reasoned that since a factor already included in the initial computation need not be separately considered for purposes of adjusting the lodestar,[84] the district court's failure to adjust the lodestar figure further did not constitute an abuse of discretion.[85]

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[76] *Id.* at 1939. The Court observed that "this calculation provides an objective basis on which to make an initial estimate of the value of a lawyer's services." *Id.*

[77] *Id.* at 1940.

[78] *Id.* at 1940 n.9 (citing Copeland v. Marshall, 641 F.2d 880, 890 (D.C. Cir. 1980)).

[79] Riddell v. National Democratic Party, 712 F.2d 165, 169-70 (5th Cir. 1983). The court also considered the fact that defendants' attorneys had been prevented from accepting other employment during the extended litigation period. *Id.* at 169.

[80] *Id.* at 170.

[81] *Id.* The court emphasized that it required "not a meaningless exercise in parroting and answering of *Johnson*'s twelve criteria, but some assurance that the court has arrived at a just compensation based on appropriate standards." *Id.* (quoting Davis v. Fletcher, 598 F.2d 469, 470-71 (5th Cir. 1979)).

[82] *Riddell*, 712 F.2d at 170.

[83] *Id.*

[84] *Riddell*, 712 F.2d at 170 (quoting Graves v. Barnes, 700 F.2d 220, 224 (5th Cir. 1983)).

[85] *Riddell*, 712 F.2d at 170. The court noted that some confusion may have resulted from its reliance on Copeland v. Marshall, 641 F.2d 880 (D.C. Cir. 1980) in the *Copper Liquor* decision. *Riddell*, 712 F.2d at 170 n.4. In *Copeland*, the District of Columbia court applied only two adjustment factors to the lodestar: the contingent nature of the case and the quality of representation. 641 F.2d at 892-93. In the instant case, the court stated that the Fifth Circuit's preferred method was to consider the *Johnson* factors as adjustments to the lodestar. *Riddell*, 712 F.2d at 170. Furthermore, the court "instructed trial judges to consider all the *Johnson* factors other than time and labor and the customary fee *after* the lodestar has been computed." *Id.* at n.4 (citing Copper Liquor, Inc.

Although the Fifth Circuit's adoption of the lodestar approach is in accord with the method approved by the Supreme Court in *Hensley*,[86] its decision in the instant case does not require the use of an hours-reasonably-spent-times-hourly-rate method as a starting point in computing attorneys' fees.[87] Rather, the court's analysis seems to focus on whether the *Johnson* factors were considered at some point during the calculation of the fee.[88] Although the court in the instant case has strayed from the trend of its earlier decisions, it did reiterate that the *Copper Liquor* approach is preferred.[89] The present decision, however, does seem to indicate that the court is retreating from the trend of providing more guidance for the district courts that began with the *First Colonial* decision.[90] As a result, it can be fairly said that the court's decision invites confusion and may signal a step toward a more flexible standard of review in the Fifth Circuit.

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v. Adolph Coors Co., 684 F.2d 575 (5th Cir. 1983)) (emphasis in original).

The court also held that the district court's imposition of joint and several liability was not inconsistent with the Fifth Circuit's earlier opinion, nor was it an abuse of discretion, since the state officials had played a substantial role in the constitutional violation which was the basis of the suit. *Id.* at 169. In denying defendants' prelitigation expense, the court concluded that a distinction must be made between acts which "create a legal entitlement" and "acts to defend the entitlement." The court found that compensation was warranted only for the latter. The court further concluded that the defendants were entitled to a hearing on travel time and time spent preparing the case. Since the district court's opinion did not mention either of those considerations, the court reversed and remanded. *Id.* at 171.

[86] *See supra* notes 75-78 and accompanying text.

[87] *See supra* note 85 and accompanying text.

[88] *See supra* note 81. The court failed to recognize the significance of using the hours-spent-times-hourly-rate method to establish an "objective" base from which to compute the fee. The instant decision deviates from this approach by allowing the more subjective factors to be used in making lodestar calculation. *See supra* notes 25, 76.

[89] *Riddell*, 712 F.2d at 170 n.4.

[90] *See supra* text accompanying notes 55-60.

Property—Mortgages—Landowner's Subordination of Deed of Trust Is Effective Only to Extent That Lender Uses Reasonable Diligence to Ensure Loan Proceeds Are Applied to Project

Plaintiff[1] filed an action in the Chancery Court of Clay County to establish the priority of its deed of trust[2] over the interests of two lending institutions[3] and two construction lienors.[4] As an inducement for the lending institutions to fund proposed real estate developments, plaintiff had entered into a subordination agreement with the lenders through which it forfeited the existing priority of its interests in three residential lots to the interests of the defendants.[5] This agreement was silent regarding the allocation of the burden of loss that might result from a wrongful distribution of the loan proceeds.[6] Upon the financial collapse of the enterprise,[7] plaintiff brought this action maintaining that the lending institutions' negligent failure to prevent the wrongful

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[1] Plaintiff L & T Developers, Inc. was a Mississippi corporation desirous of selling three of its residential lots located in Clay County. Peoples Bank & Trust Co. v. L & T Developers, Inc., 434 So. 2d 699, 703 (Miss. 1983).

[2] Plaintiff had entered a financing agreement with developer Bruce Homes, Inc., whereby plaintiff conveyed three residential lots in Clay County by warranty deed to Bruce Homes, Inc. and received in return a promissory note for $24,000 and a deed of trust covering each of the three lots. Bruce Homes, Inc. was a defendant below but not a party to the appeal; its insolvency and consequent default precipitated the instant action. *Id.* at 702-03.

[3] Defendant Bank of Mississippi loaned $32,000 to Bruce Homes, Inc. for construction capital. Defendant Peoples Bank & Trust Co., Inc. extended two similar loans to Bruce Homes, Inc. for amounts of $31,845 and $31,605. Each of these loans was secured by a deed of trust covering one of the three tracts; all deeds were perfected as of March 27, 1981. The purpose of the loans was to finance the speculative construction of residences on each of the three lots. *Id.*

[4] *Id.* at 701-02. Defendant Joe L. Arick, sole proprietor of A & H Electrical and Refrigeration, installed electrical systems in one of the newly-constructed residences. *Id.* at 706. Upon the failure of Bruce Homes, Inc. to pay him for his services, he filed a notice of construction lien pursuant to Miss. Code Ann. § 85-7-131 (1972), the Mississippi mechanic's lien statute, and perfected his lien of record on October 8, 1981. Defendant Wickes Corporation was a supplier of materials used in the construction of one of the residences. It perfected a construction lien as of October 21, 1981. 434 So. 2d at 704.

[5] 434 So. 2d at 703. For a discussion of the interests of each of the parties, see *supra* notes 2-4.

[6] 434 So. 2d at 703.

[7] Bruce Homes diverted all the loaned funds to satisfy unrelated, short-term debts. *Id.* at 704.

disbursement of the principal nullified the priority received under the subordination agreement.[8] The lending institutions apparently relied upon the express contractual priority they enjoyed under the subordination agreement.[9] The chancellor decreed that the plaintiff's deed of trust was superior to those of the construction lenders,[10] and that the mechanics' and materialmans' liens were superior to both.[11] On appeal, the Mississippi Supreme Court, *held*, affirmed.[12] Unless otherwise expressly provided, a landowner's contractual subordination of the lien of his deed of trust to a construction lender's lien is effective only to the extent that the construction lender performs his duty to use reasonable diligence to insure that the loan proceeds are applied to the construction project. *Peoples Bank & Trust Co. v. L & T Developers, Inc.*, 434 So. 2d 699 (Miss. 1983).

Despite the difficulties inherent in their use, subordination agreements have emerged as a major source of construction financing.[13] Typically a developer who lacked either sufficient capital or the will-

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[8] *Id.*

[9] *Id.* at 704, 713.

[10] *Id.* at 702. The chancellor made express findings of fact that the loan proceeds had not been used in the construction projects and that the lending institutions had acted inequitably in not preventing the wrongful distribution. *Id.* at 704. These factors, the chancellor reasoned, brought the defendants within the rule of Grenada Ready-Mix Concrete, Inc. v. Watkins, 453 F. Supp. 1298 (N.D. Miss. 1978), that subordination agreements were enforced as written unless inequitable conduct on the part of the construction lenders militated otherwise. 434 So. 2d at 712.

[11] 434 So. 2d at 702. In regard to the construction liens vis-a-vis the lenders' deeds of trust, the chancellor held that the construction lenders failed to exercise reasonable diligence to ensure the disbursed funds were actually being used for construction. *Id.* at 708. For a discussion of the due diligence rule provided in Guaranty Mortgage Co. v. Seitz, 367 So. 2d 438, 441 (Miss. 1979), see *infra* notes 64-74 and accompanying text. Consequently, the lenders were deemed to have forfeited the priority of their deeds of trust. 434 So. 2d at 707-08.

[12] 434 So. 2d at 715. The supreme court affirmed the chancellor's reasoning regarding the due diligence rule. *Id.* at 708. In addition, the court clarified a troublesome earlier decision. *Id.* at 710-11. In *Guaranty Mortgage Co.*, the court held that the foreclosure of a senior deed of trust would not operate to sever junior mechanics' and materialmen's liens. 367 So. 2d at 443; *see also infra* notes 72-74 and accompanying text. *Peoples Bank & Trust Co.* did not formally overrule the *Guaranty Mortgage Co.* decision, although it narrowly interpreted *Guaranty Mortgage Co.* to require post-foreclosure survival of a junior lien only where the mortgagee has conducted himself inequitably such as by purchasing at the trustee's sale for an unconscionably low value. 434 So. 2d at 710.

[13] G. OSBORNE, G. NELSON & D. WHITMAN, REAL ESTATE FINANCE LAW § 12.9, at 776 (1979). *See generally* R. KRATOVIL & R. WERNER, MODERN MORTGAGE LAW AND PRACTICE §§ 30.01-.23 (2d ed. 1981) (discussing general legal and practical principles involved in subordination agreements); Miller, Star & Regalia, *Subordination Agreements in California*, 13 UCLA L. REV. 1298, 1298-1302 (1966)(same).

ingness to commit his resources to sustain a long-term construction project purchased real estate from a speculative landowner and gave a purchase money deed of trust, a small down payment, and his promissory note for the balance of the purchase price as consideration.[14] Usually the transaction was premised upon the vendor's agreement to subordinate the priority of his interest to a second deed of trust given by the developer to an institutional lender as security for a construction loan.[15] If construction proceeded as the parties initially contemplated, then the interests of each were protected.[16] If the construction lender's investment, however, exceeded the increased value of the real estate due to construction, then the landowner's security was consumed.[17]

A landowner in this position often desired to reassert the priority of his subordinated deed of trust over that of the construction lender.[18]

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[14] Comment, *Purchase Money Subordination Agreements in California: An Analysis of Conditional Subordination*, 45 S. CAL. L. REV. 1109, 1110 (1972) [hereinafter cited as Comment, *Conditional Subordination*]. The seller is usually induced to undertake the risk of subordinating the priority of his lien by the offer of an inflated purchase price. Comment, *Subordination of Purchase-Money Security*, 52 CALIF. L. REV. 157, 157 (1964) [hereinafter cited as Comment, *Subordination of Purchase-Money Security*]. Furthermore, the delayed receipt of purchase money installments may enable the landowner to achieve tax benefits under I.R.C. § 453 (1976). G. OSBORNE, G. NELSON & D. WHITMAN, *supra* note 13, § 12.9, at 776 n.13.

[15] Abbott, *Some Basic Priority Problems in a Land Development Project in Mississippi with Emphasis Upon Power of Sale Foreclosure Procedures*, 50 MISS. L.J. 665, 667 (1979). Lending institutions usually require first security interest either because of statutory requirements or practical business concern. *Id.* at 667. For representative statutes, see 12 U.S.C. § 371(a)(1) (1976) (national banks); 12 U.S.C. § 1464(c)(1)(B) (1976) (federal savings and loans); N.J. STAT. ANN. § 17:9A-65(A)(3) (West. Supp. 1981-82) (restricting construction loan security to first lien). Subordination is accomplished by one of four methods. First, a subordination agreement may be executed after an earlier recording of the purchase money mortgage. Second, the purchase money mortgage may contain an automatic subordination provision. Third, a subordination agreement may be executed pursuant to an express provision in the earlier recorded deed of trust. Finally, subordination can be accomplished by order of recording. Korngold, *Construction Loan Advances and the Subordinated Purchase Money Mortgagee: An Appraisal, a Suggested Approach, and the ULTA Perspective*, 50 FORDHAM L. REV. 313, 314 n.7 (1981).

[16] Korngold, *supra* note 15, at 315-16. Theoretically, the increase in value of the land due to construction would correspond to the amount of disbursements under the construction loan. *Id.*

[17] *Id.* at 316. Typically, the subordinated landowner's security was exhausted when the construction lender negligently allowed funds to be wrongfully diverted from the project by the developer. *Id.*

[18] Comment, *Conditional Subordination*, *supra* note 14, at 1112. Alternatively, the seller could have completed the project with his own resources or purchased the superior interest held by the construction lender; however, as a practical matter, the typical size

The courts have reacted differently to the landowner's plight. A majority of jurisdictions that have considered the relative equities of a subordinating landowner who has lost his security vis-a-vis a construction lender who has negligently allowed the diversion of loan proceeds by a developer have announced what is now the general rule that, absent fraud or some similarly culpable conduct on the part of the lender, the landowner is without remedy.[19]

The development of the rule began with the holding of the Iowa Supreme Court in *Iowa Loan & Trust Co. v. Plewe*.[20] In this action by a subordinating landowner against a construction lender,[21] the supreme court rejected the plaintiff's argument that the defendant, by his conduct, had forfeited the contractual superiority of his deed of trust.[22] The court stated the general rule that a construction lender owed no duty to follow the loan proceeds into the construction project, but provided neither reasoning nor authority to support this proposition.[23]

Subsequent courts espousing this rule enumerated several possible

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of the construction loan relative to the seller's financial condition closed these options. *Id.*

[19] *See, e.g.*, Gill v. Mission Sav. & Loan Ass'n, 236 Cal. App. 2d 753, 757, 46 Cal. Rptr. 456, 458-59 (1965) (following general rule of no lender responsibility without proof of fraud or collusion); Drobnick v. Western Fed. Sav. & Loan Ass'n, 479 P.2d 393, 397 (Colo. Ct. App. 1970) (same); Hyatt v. Maryland Fed. Sav. & Loan Ass'n, 42 Md. App. 623, 629, 402 A.2d 118, 122 (1979) (same). *See generally* 4 AMERICAN LAW OF PROPERTY § 16.106D, at 208 (A. Casner ed. 1952) (collecting cases in support of majority rule); R. KRATOVIL & R. WERNER, *supra* note 13, § 30.06, at 480 (same).

[20] 202 Iowa 79, 209 N.W. 399 (1926). An earlier case, Tripp v. Babcock, 195 Mass. 1, 80 N.E. 583 (1907) is often cited by some courts as the origin of the majority rule but has been distinguished by one commentator as involving an express agreement between the subordinating landowner and lender that the loan proceeds were intended for other than construction-related expenses. Korngold, *supra* note 15, at 324-25.

[21] A portion of the loan proceeds were used by the developer to satisfy debts unrelated to the construction project and owed by the developer to the lender. Consequently, the developer had insufficient capital to complete the construction project and was forced to default upon the plaintiff's purchase money mortgage. 209 N.W. at 400.

[22] *Id.*

[23] *Id.* Despite the fact that the *Iowa Loan & Trust Co.* decision has been recognized as original authority for the general rule, the holding has been the subject of much criticism. *See* Korngold, *supra* note 15, at 327-28. First, as support for its decision, the court stated that the construction lender was not "chargeable as a trustee to see that the funds were applied by [the developer]." 209 N.W. at 400. It has been observed that the plaintiff made no claim regarding fiduciary duty. Korngold, *supra* note 15, at 328. Second, the lender had actual knowledge of the developer's diversion of the loan proceeds. 209 N.W. at 400. Typically, such conduct on the part of a construction lender brings the subordination within the fraud and collusion exception to the majority rule. Korngold, *supra* note 15, at 328.

justifications.[24] Other courts and commentators supporting the contrary proposition have been equally prolific in exposing its inequities.[25] The inherent inequities of the majority rule led courts to search for alternate standards upon which to adjudge the relative rights of subordinating landowners and construction lenders.[26]

One such alternative approach was the voluntary-obligatory doctrine,[27] under which a subordinated purchase money mortgagee would regain the priority of his interest to the extent that the construction lender made non-obligatory advancements of loaned funds to the developer as determined by the financing agreement.[28] Exemplifying the operation of this rule was *Housing Mortgage Corp. v. Allied Construc-*

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[24] *See, e.g.*, Grenada Ready-Mix Concrete, Inc. v. Watkins, 453 F. Supp. 1298, 1313 (N.D. Miss. 1978) (stating "when parties see fit to enter into contractual arrangements, their rights and obligations are to be measured by the terms thereof, without help or assistance from the court"); Gluskin v. Atlantic Sav. & Loan Ass'n, 32 Cal. App. 3d 307, 316-17, 108 Cal. Rptr. 318, 324 (1973) (finding subordination transaction to be a joint venture where subordinator assumes the risk of diversion of funds); Gill v. Mission Sav. & Loan Ass'n, 236 Cal. App. 2d 753, 757, 46 Cal. Rptr. 456, 459 (1965) (where contract imposes no duty on the lender to supervise distribution of loan proceeds, no "moral blame" attaches to his conduct if he does not); Rockhill v. United States, 288 Md. 237, 418 A.2d 197, 204 (1980) (refusing to find duty on the basis of potential derogation of recording statutes and parties' freedom to contract otherwise); Tuscarora, Inc. v. B.V.A. Credit Corp., 218 Va. 849, 241 S.E.2d 778, 782-83 (1978) (holding that the court "cannot make a more equitable agreement for one who has voluntarily contracted to his detriment").

[25] *See, e.g.*, Korngold, *supra* note 15, at 320-21, 357-60 (while a subordinating landowner assumes entrepreneurial risks that development is ill-conceived or under-funded, he does not assume potential lender negligence as subordination agreement founded upon legitimate reliance upon the expertise of the lender); *see also* Miller v. Citizens Sav. & Loan Ass'n, 248 Cal. App.2d 555, 56 Cal. Rptr. 844, 850-51 (1967) (requiring express contractual abrogation of lender responsibility since voluntary relinquishment of security by subordinator is unlikely).

[26] Korngold, *supra* note 15, at 329.

[27] *See generally* R. KRATOVIL & R. WERNER, *supra* note 13, §§ 11.02-.03, at 159-61 (discussing voluntary/obligatory doctrine); G. OSBORNE, G. NELSON & D. WHITMAN, *supra* note 13, § 12.7, at 759-71 (same); Kratovil & Werner, *Mortgages for Construction and the Lien Priorities Problem—The "Unobligatory" Advance*, 41 TENN. L. REV. 311, 314-16 (1974) (discussing voluntary/obligatory doctrine from point of view of lender).

[28] *See, e.g.*, Heller v. Gate City Bldg. & Loan Ass'n, 75 N.M. 596, 408 P.2d 753, 755 (1965) (applying voluntary/obligatory distinction to deny priority to a portion of a construction lender's mortgage principal comprised of optional advances); Security Trust Co. v. Graney, 89 Misc. 2d 290, 391 N.Y.S.2d 46, 48-49 (Sup. Ct. 1977) (same); *cf.* North v. J.W. McClintock, Inc., 208 Miss. 289, 299-301, 44 So. 2d 412, 414 (1950) (applying voluntary/obligatory distinction to future advance clause contained in deed of trust). *See generally* Annot., 80 A.L.R.2d 179, 191-203 (1961) (collecting cases following voluntary/obligatory doctrine).

tion Inc.,[29] in which the Supreme Court of Pennsylvania held that a construction lender had forfeited the priority of its construction loan mortgage by advancing loan proceeds in a manner inconsistent with a contractually stipulated schedule.[30] To the extent that the lender was deemed to have acted wrongfully, the landowner's subordinate purchase money mortgage regained priority.[31]

Although the rule of *Housing Mortgage Corp.* appeared to protect the interests of the landowner, it was roundly criticized as being inapt to the issues to which it was applied.[32] The mechanical operation of the rule failed to take into account the factual circumstances[33] and practical business concerns that underlay and motivated the lender's optional advances.[34] Consequently, the rule has been condemned both by

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[29] 374 Pa. 312, 97 A.2d 802 (1953). The landowner in this case had subordinated his purchse money mortgages to security interests subsequently taken by the construction lender in consideration for a loan. The construction loan agreement executed by both landowner and lender expressly provided for the distribution of loan proceeds to the developer pursuant to a specified progress schedule. The lender, however, paid out portions of the loan prior to the time called for by this schedule. 97 A.2d at 803. Upon the developer's default, the lender instituted foreclosure proceedings. The landowner intervened and claimed the priority of his interests on account of the lender's noncompliance. *Id.* at 804.

[30] *Id.* at 802.

[31] *Id.* at 804. In so holding, the court rejected the auditor's finding of substantial compliance on the part of the lender. *Id.*

[32] *See, e.g.*, Korngold, *supra* note 15, at 330-33 (voluntary/obligatory rule fails to address basis for actions of lender; consequently, conflict of priorities under rule degenerates into "simply a matter of courts' labelling the interests and dropping them into the appropriate boxes . . . .").

[33] Korngold, *supra* note 15, at 336. For example, in Turner v. Lytton Sav. & Loan Ass'n, 242 Cal. App. 2d 457, 51 Cal. Rptr. 552 (1966), a construction lender, waiving an earlier technical default by the developer, resumed payments under the financing agreement. The loan principal was ultimately consumed before completion of the construction project, and the developer consequently defaulted. The landowner tried to reassert the priority of its interest, claiming that all payments after the initial default were voluntary and thus subordinate. Although the court found relief for the lender on other grounds, it intimated that under the voluntary/obligatory rule, the landowner would have prevailed despite the trial court's finding that *all* of the loan proceeds were used in the project. 51 Cal. Rptr. at 552-54. The voluntary/obligatory doctrine has been criticized for failing to take into account the ends to which the construction loans are used or the reasonableness of the lender's conduct. *See, e.g.*, Korngold, *supra* note 15, at 336.

[34] Kratovil & Werner, *supra* note 27, at 313. Since a construction lender's interests are also secured by the mortgaged premises, the lender must consider the maintenance of the priority of its interests, the susceptibility of the partially completed project to vandalism, the weather, the depreciation, and the time value of its investment. *Id.* Therefore, economic compulsion is often a greater impetus to lender conduct than legal compulsion. *Id.* at 317.

the commentators[35] and some state legislatures.[36]

The trend towards greater lender responsibility in situations in which a subordinated purchase money mortgagee has lost his security was greatly advanced by the landmark decision of the California Court of Appeals in *Middlebrook-Anderson v. Southwest Savings & Loan Association.*[37] Before the court of appeals in *Middlebrook-Anderson* was a claim against a construction lender by a subordinated landowner who in material part alleged that the lender had wrongfully failed to prevent the diversion of a substantial amount of loan proceeds by the developer and that, consequently, his junior security interest had been consumed.[38] The defendant construction lender asserted four defenses: first, the absence of a duty on its part to monitor proceed distribu-

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[35] *See, e.g.*, G. OSBORNE, G. NELSON & D. WHITMAN, *supra* note 13, at 765, concluding:

> Hence, the net result of the rule which deprives optional advances of their priority may well be to give a few lien claimants windfalls (in cases in which the lender is ignorant of the rule or misjudges its applicability), but to harm the great majority of lien claimants by encouraging knowledgeable lenders to foreclose immediately when a default occurs or the loan is exhausted.

Id.

[36] *See, e.g.*, CAL. CIV. CODE § 1188-1 (West 1968) (extending range of obligatory advances to include payments of mechanics' liens and for improvements in real property); CONN. GEN. STAT. ANN. § 49-3 (West Supp. 1983) (granting priority without distinction as to optional or obligatory nature provided advance used for land improvement); FLA. STAT. ANN. § 697.04 (West Supp. 1983) (unconditional abrogation of voluntary/obligatory rule); MD. REAL PROP. CODE ANN. § 7:102(b) (1981) (same); S.C. CODE ANN. § 29-3-50 (Law. Coop. Supp. 1982) (same). For complete discussion of various statutes, see G. OSBORNE, G. NELSON & D. WHITMAN, *supra* note 13, at 768-69.

The proposed Uniform Land Transactions Act § 3-301(b)(4) would abrogate the voluntary/obligatory doctrine as follows: "A recorded security interest takes priority as of the date of its recording as to advances or obligations thereafter made or incurred under the security agreement if made under a construction security interest to enable completion of the agreed improvement of the real estate . . . ." For further discussion of this provision, see Bruce, *Mortgage Law Reform Under the Uniform Land Transactions Act*, 64 GEO. L.J. 1245 (1976).

[37] 18 Cal. App. 3d 1023, 96 Cal. Rptr. 338 (1971).

[38] *Id.* at 1029, 96 Cal. Rptr. at 341. Plaintiff first alleged that it materially relied upon the buyer-developer's express representation that the construction loan proceeds would be used solely for expenses related to the planned construction of improvements on the property, and that the lender failed to adhere to this representation by allowing $300,000 to be diverted by the developer for other purposes. In a second count, the plaintiff alleged that its material reliance upon the defendant's knowledge of its junior interest and voluntary assumption of the duty to supervise the disposition of loan proceeds gave rise to an implied agreement on the part of the lender to do the same. *Id.* at 1029-30, 96 Cal. Rptr. at 341.

tion;[39] second, the absence of privity between the lender and the plaintiff;[40] third, the lack of a subordination agreement;[41] and fourth, the failure of the plaintiff to raise a significant issue of public policy.[42]

Relying on a two-fold analysis to reverse the trial court's dismissal of the action on the pleadings,[43] the court first reasoned that the plaintiff had presumptively established the actual use of loan proceeds in the construction project as an express condition to subordination.[44] Therefore, to the extent that the lender had failed to satisfy this condition, effective subordination was prevented.[45] Because the construction

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[39] *Id.* at 1032-33, 96 Cal. Rptr. at 343-44. Since plaintiff's claim sounded in contract rather than tort, the court rejected this defense. *Id.* at 1033, 96 Cal. Rptr. at 344. *But cf.* Gill v. Mission Sav. & Loan Ass'n, 236 Cal. App. 2d 753, 756-57, 46 Cal. Rptr. 456, 458 (1965) (complaint alleging cause of action in negligence against defendant construction lender failed to state cause of action).

[40] 18 Cal. App. 3d at 1033, 96 Cal. Rptr. at 344. Since the restriction on the use of funds arose out of plaintiff's dealings with the developer and not the lender, there arguably was no privity with the defendant. *Id.*, 96 Cal. Rptr. at 344. Reasoning, however, that the lender was a third-party beneficiary of the agreement between the landowner and the developer, the court rejected this argument. *See infra* note 45 and accompanying text. *But cf.* Matthews v. Hinton, 234 Cal. App. 2d 736, 44 Cal. Rptr. 692, 695-96 (1965) (similar argument upheld where plaintiff seeking damages).

[41] 18 Cal. App. 3d at 1033-36, 96 Cal. Rptr. at 344-46. Subordination was affected by Middlebrook-Anderson's agreement to record its earlier-created security interests subsequent to defendant's recording of its construction loan security. The court concluded that there was no legal distinction between subordination by contractual agreement and subordination by order of recording. *Id.* at 1034, 96 Cal. Rptr. at 344. *But cf.* Spaziani v. Millar, 215 Cal. App. 2d 667, 30 Cal. Rptr. 658, 661-63 (1963) (subordination by order of recording not subject to attack). *See generally* Miller, Star & Regalia, *supra* note 13, at 1309 (discussing order of recording as evidence of priority).

[42] 18 Cal .App. 3d at 1033, 1037-38, 96 Cal. Rptr. at 345, 348.

[43] Plaintiff and landowner Middlebrook-Anderson appealed from the trial court's dismissal without leave to amend its complaint against construction lender Southwest Savings & Loan. *Id.* at 1023, 96 Cal. Rptr. at 338.

[44] *Id.* at 1037-38, 96 Cal. Rptr. at 347. Since the case was before the court on the pleadings, plaintiff's allegations were accepted as true. *Id.* at 1027, 96 Cal. Rptr. at 338. The *Middlebrook-Anderson* court's reliance upon the presence of this express condition has caused the applicability of this decision to the usual subordination transaction where no such condition is involved to be questioned. *See* Korngold, *supra* note 15, at 341.

[45] 18 Cal. App. 3d at 1033, 96 Cal. Rptr. at 344. More specifically, the court held that plaintiff's interests were only *conditionally subordinated* and reasoned as follows:

> [T]he lender is a third-party beneficiary in the seller-buyer agreement, but only to the extent that it abides by the condition of subordination. If the lender does not comply with the seller's conditions, it does not achieve priority. Since one condition to priority is the proper use of the construction loan funds, the priority of the construction loan lien does not vest until such time as the funds are applied to the construction purpose.

Id., 96 Cal. Rptr. at 344; *see also* Miller v. Citizens Sav. & Loan Ass'n, 248 Cal. App. 2d

lender had allowed a portion of the funds to be used otherwise than in construction, the plaintiff had stated a valid claim.[46] Although this initial reasoning was sufficient to require reversal, the court further addressed the policy considerations in support of the plaintiff's claim of an implied agreement on the part of the construction lender to supervise the developer's use of construction proceeds.[47] The court concluded that, as a matter of policy, such an agreement should be implied into the subordination transaction.[48]

The continuing dissatisfaction with the majority rule[49] of construction lender non-liability and the *Middlebrook-Anderson* positions of conditional subordination[50] and implied agreement[51] has led some courts to impose a direct tort duty on the lender to use due care in advancing loan proceeds.[52] The Alaska Supreme Court found lender li-

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555, 56 Cal. Rptr. 844, 850 (1967) (applying doctrine of conditional subordination); Collins v. Home Sav. & Loan Ass'n, 205 Cal. App.2d 86, 22 Cal. Rptr. 817, 823 (1962) (same).

[46] 18 Cal. App. 3d at 1036-37, 96 Cal. Rptr. at 346-47. The failure of the court to specify the seller's remedy has led some commentators to criticize the *Middlebrook-Anderson* decision as placing the lender in the position of an insurer. *See, e.g.*, Korngold, *supra* note 15, at 344. Typically courts adopting the conditional subordination theory apportion the subordination if possible. *See, e.g.*, Miller v. Citizen Sav. & Loan Ass'n, 248 Cal. App.2d 555, 56 Cal. Rptr. 844, 852 (1967) (apportioning extent of subordination to degree of compliance). *But cf.* Ruth v. Lytton Sav. & Loan Ass'n, 266 Cal. App. 2d 831, 72 Cal. Rptr. 521, 523 (1968) (total failure of subordination on account of non-compliance of loan agreement with subordination agreement); Jones v. Sacramento Sav. & Loan Ass'n, 248 Cal. App. 2d 522, 56 Cal. Rptr. 741, 744 (1967) (same).

[47] 18 Cal. App. 3d at 1036-37, 96 Cal. Rptr. at 346-47. The policy concerns considered by the court included the following: the lender's superior position, as the source of the loan proceeds, to police the distribution and demand documented accounting by the developer; the lender's expertise and ability to inspect the progress of construction and to verify the developer's withdrawals; the lender's ability to satisfy the seller's junior lien and acquire senior interest at a purchase price below fair market value; the construction lender's typically sounder financial condition, enabling him to more easily absorb a loss; the availability to the lender of an action for the deficiency; the ability of the lender to diffuse the burden of loss as an expense of operation; and finally, the impetus to provide for such contingencies by express contractual provision. *Id.* at 1037, 96 Cal. Rptr. at 346-47; *see also* Handy v. Gordon, 65 Cal. 2d 578, 422 P.2d 329, 331, 55 Cal. Rptr. 769, 771 (1967) (discussing policy considerations regarding subordination transactions).

[48] 18 Cal. App. 3d at 1038, 96 Cal. Rptr. at 347.

[49] *See supra* notes 19-25 and accompanying text.

[50] *See supra* notes 45-46 and accompanying text.

[51] *See supra* notes 47-48 and accompanying text.

[52] *See, e.g.*, Big Land Inv. Corp. v. Lomas & Nettleton Fin. Corp., 657 P.2d 837, 839-40 (Alaska 1983) (applying negligence theory but finding no relief for plaintiff on facts); Commercial Standard Ins. Co. v. Bank of America, 57 Cal. App. 3d 241, 248-49, 129 Cal. Rptr. 91, 95 (1976) (lender held liable for negligent disbursement to surety forced to

ability under a negligence-based tort theory in *Fikes v. First Federal Savings & Loan Association.*[53] The court was faced with the claim of a vendee under a real estate sales contract against a construction lender who had carelessly allowed the vendor-developer to divert loan proceeds.[54] Although there was no privity between the lender and the vendee,[55] the court held that the lender had a responsibility to the plaintiff to use reasonable care in supervising loan advancements to the developer.[56] Although some courts have reluctantly applied the tort duty exemplified by *Fikes*[57] and others have rejected it outright,[58] the tort theory seemed to be the next logical step in the progression toward direct lender responsibility.[59]

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indemnify contractor's default); Cook v. Citizens Sav. & Loan Ass'n, 346 So. 2d 370, 371-72 (Miss. 1977) (upholding post-foreclosure construction liens where lender failed to use reasonable diligence in disbursing loan funds to landowner); *cf.* Glencoe State Bank v. Cole, 265 Ill. App. 158 (1932) (direct duty on construction lender arising out of construction loan contract, lender's knowledge of subordinated interest of purchase money mortgage, and inequity involved in allowing lender negligence). For a more complete discussion of this case, see Korngold, *supra* note 15, at 349.

[53] 533 P.2d 251 (Alaska 1975).

[54] *Id.* at 254-61.

[55] *Id.* at 260. Indeed, one writer has stated that privity has been the greatest obstacle to finding construction lender liability. Korngold, *supra* note 14, at 347-48; *see also* Roberts v. Harkins, 292 So. 2d 603, 605 (Fla. Dist. Ct. App. 1974) (expressly finding lack of privity between subordinated landowner and construction lender and rejecting implied duty theory); Rockhill v. United States, 288 Md. 237, 418 A.2d 197, 198 (1980) (same).

[56] 533 P.2d at 261.

[57] *See, e.g.*, Cambridge Acceptance Corp. v. Hockstein, 102 N.J. Super. 435, 246 A.2d 138, 141 (1968) (holding that a construction lender would not forfeit the priority of its interests on account of "mere negligence" but that "plain principles of equity at least call for such a construction lender to make and administer the loan in the conventional manner . . . .").

[58] *See, e.g.*, Gill v. Mission Sav. & Loan Ass'n, 236 Cal. App. 2d 753, 46 Cal. Rptr. 456, 458 (1965) (rejecting an imposition of a tort duty upon the construction lender); Forest, Inc. v. Guaranty Mortgage Co., 534 S.W.2d 853, 856-57 (Tenn. Ct. App. 1976) (same).

In Grenada Ready-Mix Concrete, Inc. v. Watkins, 453 F. Supp. 1298 (N.D. Miss. 1978), the court examined at length the subordinated landowner's claim of an implied duty of reasonable supervision on the part of the construction lender. Since the court was *Erie* bound and since the issue had not been considered by the Mississippi courts, the court concluded that the construction lender should benefit from the reasonable diligence rule as applied by the Mississippi courts with respect to construction liens. Although the court enumerated the policy reasons behind *Middlebrook-Anderson* and its progeny, it concluded that the Mississippi Supreme Court would adopt the majority rule of no lender responsibility. *Id.* at 1313-14.

[59] Korngold, *supra* note 15, at 351.

Concomitant with the developing trend toward increased construction lender responsibility in other jurisdictions, a similar line of authority arose in Mississippi regarding construction lenders vis-a-vis mechanics and materialmen. The priority of the statutory liens impressed by unpaid construction lienors in relation to an earlier recorded deed of trust securing a loan by a construction lender was first considered by the Mississippi Supreme Court in *Weiss, Dreyfous & Seiferth, Inc. v. Natchez Investment Co.*[60] There the court announced the rule that the record priority enjoyed by the lender could be asserted against unpaid mechanics and materialmen with statutory construction liens only to the extent that the loan proceeds were actually used to discharge the expenses of construction.[61]

The rule enunciated in *Weiss* subsequently was attenuated in *First National Bank of Greenville v. Virden.*[62] Although apparently reaffirming the rule that a construction lender forfeited its priority when loan proceeds were diverted from the construction project the supreme court added that the lender was under a duty of only reasonable, not absolute, diligence in protecting the interests of construction lienors.[63]

Subsequent refinement[64] of the language in *Virden* resulted in the

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[60] 166 Miss. 253, 140 So. 736 (1932). To finance the construction of a hotel, the landowner had issued bonds secured by a deed of trust on the property. After construction was completed, the landowner was placed in receivership, precipitating the conflict between the secured lender and the unpaid mechanics and materialmen. *Id.* at 257, 140 So. at 736.

[61] *Id.* at 260, 140 So. at 738. Citing Kentucky Lumber & Mill Work Co. v. Kentucky Title Sav. Bank & Trust Co., 184 Ky. 244, 211 S.W. 765 (1911), and Landers-Morrison-Christensen Co. v. Ambassador Holding Co., 171 Minn. 445, 214 N.W. 503 (1927), the court observed that construction lenders were generally allowed to rely on the record priority of their security interests. Moreover, the court noted the construction lienors had constructive notice both of the lender's earlier recorded deeds of trust and of the common intention of the landowner and the lender that these deeds of trust would be paramount. Nevertheless, it concluded that the lender's priority should be circumscribed to the extent that the loan proceeds were wrongfully disbursed. 166 Miss. at 260, 140 So. at 738.

[62] 208 Miss. 679, 45 So. 2d 268 (1950).

[63] *Id.* at 685, 45 So. 2d at 270-01. The reference to the construction lender's duty of reasonable diligence in policing proceeds distribution is arguably dicta. The court stated that "[i]t is simple justice that such mortgagee shall have preference only to the extent that its funds *actually* went into construction." *Id.*, 45 So. 2d at 271. Such a distinction is largely academic under later interpretations of *Virden*. *See infra* notes 64-74 and accompanying text.

[64] *See* North Am. Mortgage Investors v. Mississippi Hardware Co., 360 So. 2d 1203, 1205 (Miss. 1978) (applying rule of reasonable diligence to determine the relative priority of mechanics' and materialmens' liens in relation to security interest held by construc-

guidelines expressed in *Guaranty Mortgage Co. v. Seitz*,[65] which involved an action by several mechanics and materialmen[66] to impress subsequently acquired statutory[67] construction liens upon the construction lender's deed of trust.[68] Under the rule in *Guaranty Mortgage Co.* a construction lender owed a duty to mechanics and materialmen to use reasonable diligence in the supervision of advancements of loan proceeds; therefore, an otherwise superior deed of trust securing a construction loan had priority "only to the extent that; [sic] (a) the funds disbursed actually went into the construction, or (b) to the extent that the construction lender used reasonable diligence in disbursing the construction loan."[69] The trial court had made findings of fact

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tion lender); Wortman & Mann, Inc. v. Frierson Bldg. Supply Co., 184 So. 2d 857, 860 (Miss. 1966) (same); Southern Life Ins. Co. v. Pollard Appliance Co., 247 Miss. 211, 221, 150 So. 2d 416, 420 (1963) (same); Deposit Guar. Bank & Trust Co. v. J.F. Weaver Lumber Co., 215 Miss. 183, 191, 60 So. 2d 598, 600 (1952) (same).

[65] 367 So. 2d 438 (Miss. 1979).

[66] Plaintiffs were unpaid mechanics and materialmen involved in the construction of a shopping center financed by defendant construction lender. *Id.* at 440.

[67] The general construction lien statute in Mississippi provides in pertinent part as follows:

> Every house, building, water well or structure of any kind, and any fixed machinery, gearing, or other fixture that may or may not be connected therewith, . . . erected, constructed, altered, or repaired . . . shall be liable for the debt contracted and owing, for labor done or materials furnished, . . . and [the] debt for such services or construction shall be a lien thereon. The . . . laborers, and materialmen and/or contractors who rendered services and constructed the improvements shall have a lien therefor . . . . Such lien shall take effect as to purchasers or encumbrancers for a valuable consideration without notice thereof, only from the time of commencing suit to enforce the lien, or from the time of filing the contract under which the lien arose, or notice thereof, in the office of the clerk of the chancery court, as hereinafter stated; . . . .

MISS. CODE ANN. § 85-7-131 (Supp. 1982).

[68] 367 So. 2d at 438. The construction lender's deed of trust was perfected of record on August 5, 1974. On April 25, 1975, mechanics and materialmen filed their Notices of Construction Liens, and on September 24, 1975, an action was instituted to enforce these liens. *Id.* at 440-41.

[69] *Id.* at 441; *accord* Kentucky Lumber & Mill Work Co. v. Kentucky Title Sav. Bank & Trust Co., 184 Ky. 244, 211 S.W. 765, 768 (1919) (making ultimate disposition of loan proceeds a material factor in determining priority of lender's interest vis-a-vis that of mechanics and materialmen); Colby & Dickinson, Inc. v. McCulloch, 145 Wash. 561, 261 P. 86, 88 (1927) (imposing duty upon construction lender to see that proceeds are actually used in project). *But see* National Lumber Co. v. Farmer & Son, Inc., 251 Minn. 100, 87 N.W.2d 32, 35-36 (1957) (no duty to supervise use of loan proceeds involved); *cf.* House v. Scott, 244 Ark. 1075, 429 S.W.2d 108, 112 (1968) (under statute providing for priority of construction loan mortgage, ultimate disposition of proceeds not controlling).

that only a portion of the construction loan had actually been used in the construction project and that the remainder had been diverted because of the lender's negligent supervision.[70] Consequently, the construction lender had priority only over that amount of the loan that was actually used for construction purposes.[71]

Guaranty Mortgage Co., however, extended the rights of the mechanics and materialmen even further. Although the construction lender's interest had been validly foreclosed,[72] the court held that such foreclosure did not operate to sever the interests of the mechanics and materialmen in the land and transfer them to the proceeds of the public sale.[73] Rather, the court held that the mechanics' and materialmen's liens remained valid and enforceable.[74]

In the instant case, the court merged the notion of lender responsibility with the Mississippi rule regarding materialmen's and mechanics' liens to impose a duty on a construction lender to a subordinating

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[70] 367 So. 2d at 439-40. Guaranty Mortgage Co. did not appeal from the chancellor's finding that it was negligent in allowing the developer to commingle the construction loan advances with other construction accounts and thereby to divert all but $583,795.48 of the $1,125,000 principal for other purposes. *Id. Compare* Southern Life Ins. Co. v. Pollard Applicance Co., 247 Miss. 211, 217, 150 So. 2d 416, 418 (1963) (no reasonable diligence where lender did not supervise disposition of loan proceeds, could not identify materialmen and mechanics, assumed construction lienors were being paid, and relied on developer's undocumented statements of account) *with* Wortman & Mann, Inc. v. Frierson Bldg. Supply Co., 184 So. 2d 857, 859 (Miss. 1966) (reasonable diligence found where loan proceeds were advanced by attorney of title insurance company who searched records periodically for construction liens, and required contractor's affidavit that potential construction lienors had been paid).

[71] 367 So. 2d at 442. For later applications of the rule of reasonable diligence, see Self v. Nelson, 402 So. 2d 822, 824 (Miss. 1981); Deposit Guar. Nat'l Bank v. E.Q. Smith Plumbing & Heating, Inc., 392 So. 2d 208, 212 (Miss. 1980).

[72] On September 2, 1975, Guaranty Mortgage Co. purchased the development at the trustee's sale for $700,000. 367 So. 2d at 441.

[73] *Id.* at 442-43. The court reasoned that the *lis pendens* notice filed one day before the foreclosure prevented the severance of the otherwise junior construction liens. *Id.* at 443-44.

[74] *Id.* However, in United States v. Boyd, 246 F.2d 477, 483 (5th Cir. 1957), the court held that under Mississippi law, "when a mortgage has been validly foreclosed by a non-judicial sale under a power, it is the consequence of such prior lien and the right of enforcement under it which destroys the junior encumbrance whether it be a private or Federal tax lien." Sharp criticism has been levelled at the *Guaranty Mortgage Co.* decision which, in the view of Professor Abbott, introduced much uncertainty into the construction lending industry in Mississippi, inhibited free bidding at foreclosure sales, and required in almost every case a judicial foreclosure. *See* Abbott, *supra* note 15, at 687. Indeed, it has been suggested that "the Mississippi Supreme Court take the first opportunity to overrule its decision in [*Guaranty Mortgage Co.*] and restore order to a vital industry in the state." *Id.* at 688.

landowner to use reasonable diligence in supervising the expenditure of the proceeds of a construction loan.[75] Because the lender was in the business of making and supervising such loans and, therefore, presumptively possessed greater expertise than the relatively unsophisticated landowner, the lender was in the better position to bear this burden.[76] More specifically, since the lender physically controlled the purse strings of the loan, as between the lender and the landowner, only the former had the practical ability to regulate the manner in which these proceeds were being used.[77] Also, because the lender already bore an identical duty in relation to mechanics and materialmen,[78] its burden was not appreciably increased by extending exposure to the landowner.[79] Because the lender had altogether failed to utilize his superior position to ascertain the ends to which the loan proceeds were being applied,[80] the court concluded that the lender should bear the burden of the resultant loss.[81]

While the prevailing rule throughout the country remains one of lender non-liability,[82] many courts and commentators recognize that blind adherence to the *laissez-faire* notion of freedom of contract[83] fails to address the equities among the parties in a land development transaction.[84] The lender's position of superior ability and expertise only makes it reasonable that it should bear the burden of supervision.[85] Mississippi already accepts analogous policy considerations in

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[75] 434 So. 2d at 713. The court added that if a construction lender does not exercise reasonable diligence its deed of trust will be given priority over the landowner's purchase money deed only to the extent that loan proceeds actually were used toward the construction project. *Id.*

[76] *Id.* at 714.

[77] *Id.*

[78] *See supra* notes 10-12.

[79] 434 So. 2d at 714. The court noted the logical inconsistency of selective enforcement of the due diligence rule:

> No rational loan officer will choose to exercise such diligence—or decide to worry about that loan tomorrow—by reference to whether he happens to be thinking of potential conflicts with unpaid materialmen or with the unpaid subordinated purchase money lienor. *The duties imposed by law should be no more schizophrenic than are the people whose conduct they order.*

Id. (emphasis added).

[80] *See supra* note 12.

[81] 434 So. 2d at 27.

[82] *See supra* notes 19-24 and accompanying text.

[83] *See supra* note 24.

[84] *See supra* note 25.

[85] *See supra* note 47.

priority conflicts arising between lenders and construction lienors;[86] indeed, the instant holding does not materially alter the lender's standard of conduct, but merely increases its exposure.

When examined from the lender's point of view, the reasonable diligence rule can only be considered as a prudent business practice. By exercising care in supervision of the construction loan, the lender not only limits his liability[87] but also enhances his profit expectations.[88] Since the duty to supervise only arises upon the failure of the parties to provide otherwise, the traditional notions of freedom of contract are not offended.[89]

The net result is not to burden the lender with an intolerable increase in liability, but rather to force the issue of proceeds supervision out of the contractual interstices and to place it on the bargaining table where the true intent of the parties can be determined.[90] Only then do the phrases "liberty of contract" and "assumption of risk" have meaning.

Finally, *Peoples Bank & Trust Co.* clarifies the aberration in Mississippi law pertaining to power of sale foreclosure created by *Guaranty Mortgage Co. v. Sietz*[91] and returns Mississippi foreclosure law to its pre-*Guaranty Mortgage Co.* principles.

Daniel J. Mulholland

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[86] *See supra* notes 60-64 and accompanying text.

[87] *See supra* note 75 and accompanying text. Under the reasonable diligence rule, neither the lender nor the subordinated landowner is placed in the position of a guarantor as each may be under alternate approaches. *See supra* notes 33, 46. Therefore, the partial shift of the burden of loss enables a closer approximation of the relative equities of the parties.

[88] *See supra* notes 17-19. The maximum profits expected from a joint development project can usually be realized only if construction proceeds to fruition. Thus, by exercising reasonable diligence to insure progress as planned, the lender enhances his business expectations, protects the rights of those holding junior interests in the land, and prevents litigation of the nature of the instant case.

[89] 434 So. 2d at 713. The absence of an express contractual provision regarding the risk of non-supervision is arguably as indicative of the parties' failure to consider the issue as it is of a tacit allocation of the risk to the subordinated landowner.

[90] *Peoples Bank & Trust Co.* provides an express invitation for the parties to alter contractually the implication of a duty upon the lender to use reasonable diligence in monitoring the distribution of loan proceeds. 434 So. 2d at 713 n.11. While an express abrogation may become standard in subordination agreements, such a provision should at least put the landowner on notice of the risk he is assuming and may in some cases allow the landowner to demand a higher purchase price as compensation.

[91] *See supra* notes 12, 74.

BOOK REVIEW

MISSISSIPPI EVIDENCE

By: Carolyn Ellis and Parham H. Williams, Jr.
Norcross, Georgia: The Harrisons Company 1983
202 pp. $45.95

*W. Wayne Drinkwater, Jr.**

Mississippi lawyers have long labored without the benefit of a comprehensive summary of Mississippi's law of evidence. Governing evidentiary principles are scattered throughout the Mississippi Code and in case law stretching back more than a century. Many important evidentiary questions have never been decided at all, either by the Supreme Court of Mississippi or by the Mississippi Legislature. In Mississippi state courts, the difficulty in knowing the law of evidence is compounded by the simple difficulty of finding it.

Carolyn Ellis and Parham H. Williams, Jr., Associate Professor and Dean of the University of Mississippi School of Law respectively, have now joined forces to perform a significant service for Mississippi trial lawyers by synthesizing Mississippi's law of evidence into one compact volume. Ellis and Williams' *Mississippi Evidence* is a focused, unpretentious handbook, designed for pocket part supplementation, which organizes in a logical and easily understandable format Mississippi evidence as it exists today. Nor do Ellis and Williams ignore the influence of the Federal Rules of Evidence; each section of *Mississippi Evidence* contains the analagous provision of the Federal Rules of Evidence, set out in full text. Differences between the Rules and Mississippi practice are briefly summarized.

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Mississippi Evidence is a book for the practicing lawyer, of a size and format to encourage courtroom use. Although its lack of historical and policy discussion may make *Mississippi Evidence* unsatisfactory for the scholar, its succinctness is a blessing to the busy practitioner who is less interested in learning how to build a watch than in finding out the time. At the same time, Ellis and Williams may have forgone the opportunity to make an even greater contribution to Mississippi jurisprudence. By writing a book largely without a point of view, which states the law without arguing for needed change, Ellis and Williams have passed up the chance to exercise their considerable skills in advocating more useful evidentiary rules.

Lawyers and judges would welcome a careful exposition of the reasons behind the "national trend toward limiting . . . or eliminating the Dead Man's Statute" that Ellis and Williams have identified,[1] and why Mississippi would do well to join that movement. Similarly, it is difficult to formulate a satisfactory reason why a plaintiff in a personal injury action should be entitled to shield his physical condition with the physician-patient privilege. Ellis and Williams might usefully have detailed some of the powerful considerations supporting modification of the privilege in such cases.

But perhaps it is unfair to complain that Ellis and Williams chose not to write a different book. What is done, is well done. The eccentricities of Mississippi evidence are faithfully chronicled: No witness may express an opinion about the point of impact of motor vehicles in a collision case, such testimony threatening to "invade the province of the jury."[2] Until 1982, the voucher rule barred a party from impeaching his own witness in civil cases.[3] An ancient holding apparently still permits the use of a witness' lack of religious belief for impeachment,[4] and Mississippi has not yet abandoned its "curious rule . . . that if [an out-of-court] statement is made in the presence of a party, the statement is not considered hearsay."[5]

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[1] C. ELLIS & P. WILLIAMS, MISSISSIPPI EVIDENCE § 2-8, at 15 (1983).
[2] *Id.* § 7-2, at 89.
[3] *Id.* § 4-3, at 33.
[4] *Id.* § 4-7, at 46.
[5] *Id.* § 8-7, at 113.

Ellis and Williams are not without a lighter touch, choosing the charmingly chauvinistic case of *Riley v. State*,[6] to illustrate the principle that a party's silence in the face of an accusatory statement constitutes an admission only if the party could reasonably be expected to deny the accusation. In *Riley*, a man and his wife were jailed for murder. Late at night, at a time when they believed other inmates to be asleep, Mrs. Riley bitterly complained to her husband that although he had forced her to commit the crime, he expected her to shoulder the entire responsibility for the murder. At trial, the State introduced Riley's failure to deny the accusation—overheard by other inmates—as a tacit admission of guilt. The Supreme Court of Mississippi reversed.

> It is not always conducive to domestic peace for a husband to contradict the statements of his wife, and ordinarily the wise husband attempts to soothe and placate his irate spouse, rather than to question her statements, however wide of the truth they may be. A few husbands are brave or foolhardy, and at all hazards risk the consequences, but the law does not fix rules for the guidance of the superman, but all rules are adopted for the average . . . . Speaking for the average man, we are of the opinion that appellant was not called upon to deny the statement of his wife, made under the circumstances surrounding them at the time.[7]

Even without advocacy, *Mississippi Evidence* demonstrates the compelling need for uniform rules of evidence in Mississippi, both to eliminate confusion and to fill gaps in existing law.[8] For example, in Mississippi as elsewhere, a witness may be impeached by questions concerning his conviction of crime. In Mississippi, one must explore widely to understand the limits of any such impeachment. Under Section 13-1-13 of the Mississippi Code, a witness may be impeached by proof showing "his convic-

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[6] 107 Miss. 600, 65 So. 882 (1914).

[7] *Id.* at 607, 65 So. at 883.

[8] *See* Tollison, *A Plea for the Adoption of the Proposed Mississippi Rules of Evidence*, 53 Miss. L.J. (1983) (advocating the adoption of Uniform Rules of Evidence in Mississippi).

tion of any crime."[9] But Section 63-9-15 teaches that "any crime" does not mean "any crime;" minor traffic offenses may not be the basis of impeachment.[10] Still a third statute governs the extent to which youth court convictions may be used as impeachment.[11] No statute or court decision determines when a conviction may become too remote in time to be probative as impeachment.

In other areas, *Mississippi Evidence* demonstrates the simple absence of relevant Mississippi law. Although Ellis and Williams tell us that Mississippi "permits evidence of a habit to prove circumstantially that a person acted in conformity with such habit on the occasion in question [,]"[12] they are unable to summon even one citation of Mississippi authority for this proposition. For their equally important conclusion that evidence of custom or habit is inadmissible when direct eyewitness testimony exists, Ellis and Williams again are without Mississippi support.[13] Nor is Mississippi law clear on whether an expert witness may be required to state underlying facts supporting his opinion, or whether he may express the opinion without disclosing the supporting basis.[14] Similarly, there is little or no current Mississippi law governing hearsay exceptions admitting business records and recorded past recollections.

Other examples could be multiplied. Ellis and Williams can hardly be faulted for failing to locate law that does not exist, and the frequent absence of relevant law is a powerful reason supporting uniform rules of evidence in Mississippi.

The accuracy and simplicity of *Mississippi Evidence* destine it to achieve the same kind of eminence that V.A. Griffith's *Mississippi Chancery Practice* enjoyed for so many years. *Mississippi Evidence* also is illustrative of the service to the profession that could be rendered in even greater abundance by professors at the University of Mississippi School of Law. Similar works on other aspects of Mississippi law and practice would

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[9] MISS. CODE ANN. § 13-1-13 (1972).
[10] *Id.* § 63-9-15.
[11] *Id.* § 43-21-561.
[12] ELLIS & WILLIAMS, *supra* note 1, § 5-6, at 59.
[13] *Id.*
[14] *Id.* § 7-4, at 95.

be a welcome addition to this state's legal literature and would augment the law school's growing reputation as a regional center of legal learning.

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